SUPREME COURT, U. S.

FEB 29 1968

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JOINT APPENDIX TO BRIEFS

In the

SUPREME COURT OF THE UNITED STATES

October Term, 1967

Nos. 797, 804, 808, and 809

AMERICAN COMMERCIAL LINES, INC., ET AL., APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,
Appellants

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

INTERSTATE COMMERCE COMMISSION, APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

FILED NOVEMBER 7, 1967
PROBABLE JURISDICTION NOTED JANUARY 15, 1968

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Plaintiffs

LOUISVILLE & NASHVILLE RAILROAD COMPANY
THE PENNSYLVANIA RAILROAD COMPANY*

Intervening Plaintiffs

THE ANN ARBOR RAILROAD COMPANY
THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY
ATLANTA & WEST POINT RAIL ROAD COMPANY
ATLANTIC COAST LINE RAILROAD COMPANY
THE BALTIMORE & OHIO RAILROAD COMPANY
CENTRAL OF GEORGIA RAILWAY COMPANY
THE CHESAPEAKE & OHIO RAILWAY COMPANY
CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY
CHICAGO GREAT WESTERN RAILWAY COMPANY
CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY
CHICAGO & NORTH WESTERN RAILWAY COMPANY
CHICAGO, ROCK ISLAND & PACIFIC RAILROAD COMPANY
CLINCH FIELD RAILROAD COMPANY
THE COLORADO & SOUTHERN RAILWAY COMPANY
DETROIT, TOLEDO & IRONTON RAILROAD COMPANY
THE DENVER & RIO GRANDE WESTERN RAILROAD COMPANY
ELGIN, JOLIET & EASTERN RAILWAY COMPANY
ERIE-LACKAWANNA RAILROAD COMPANY
FORT WORTH & DENVER RAILWAY COMPANY
GEORGIA RAILROAD
GEORGIA SOUTHERN & FLORIDA RAILWAY COMPANY
GRAND TRUNK WESTERN RAILROAD COMPANY
GREAT NORTHERN RAILWAY COMPANY
GULF, MOBILE & OHIO RAILROAD COMPANY
ILLINOIS CENTRAL RAILROAD COMPANY
THE LEHIGH & HUDSON RIVER RAILWAY COMPANY
LEHIGH VALLEY RAILROAD COMPANY
MAINE CENTRAL RAILROAD COMPANY
MISSOURI-KANSAS-TEXAS RAILROAD COMPANY
MISSOURI PACIFIC RAILROAD COMPANY
THE NEW YORK CENTRAL RAILROAD COMPANY*

*Effective February 1, 1968, The New York Central Railroad Company was merged into The Pennsylvania Railroad Company, and the name of the surviving corporation was changed to Pennsylvania

THE NEW YORK, NEW HAVEN & HARTFORD RAILROAD COMPANY
NORFOLK SOUTHERN RAILWAY COMPANY
NORFOLK & WESTERN RAILWAY COMPANY
NORTHERN PACIFIC RAILWAY COMPANY
READING COMPANY
RICHMOND, FREDERICKSBURG & POTOMAC RAILROAD COMPANY
ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY
ST. LOUIS SOUTHWESTERN RAILWAY COMPANY
SEABOARD AIR LINE RAILROAD COMPANY
SOO LINE RAILROAD COMPANY
SOUTHERN PACIFIC COMPANY
SOUTHERN RAILWAY COMPANY
THE TEXAS & PACIFIC RAILWAY COMPANY
UNION PACIFIC RAILROAD COMPANY
WESTERN MARYLAND RAILWAY COMPANY
THE WESTERN PACIFIC RAILROAD COMPANY
THE WESTERN RAILWAY OF ALABAMA

v.

Defendants

UNITED STATES OF AMERICA, and
THE INTERSTATE COMMERCE COMMISSION
AMERICAN COMMERCIAL LINES, INC.
NATIONAL MOTOR FREIGHT TRAFFIC ASSOCIATION, INC.
WATERWAYS FREIGHT BUREAU
MISSISSIPPI VALLEY BARGE LINE COMPANY
OHIO RIVER COMPANY
UNION BARGE LINE CORPORATION
NATIONAL TANK TRUCK CARRIERS
AMERICAN TRUCKING ASSOCIATIONS, INC.
THE AMERICAN WATERWAYS OPERATORS, INC.

JUDGE GORDON

New York Central Transportation Company. This corporation designates itself, and is familiarly known, as Penn Central. See Pennsylvania Railroad Company - Merger - New York Central Railroad Company, 327 I.C.C. 475 (1966); 330 I.C.C. 328 (1967); Penn-Central Merger and N&W Inclusion Cases, 88 Supt. Ct. 602 (1968).

DOCKET ENTRIES

Jan. 4, 1966	Complaint filed. Summons issued and delivered to Marshal. Case referred to Judge Gordon for designation of 3-Judges.
Jan 6, 1966	Return on service of writ as to U.S. (Asst. U.S. atty, 3 copies to Atty. Gen. U.S. by mail) and on the Interstate Commerce Commission (registered mail), on 1-5-66.
Jan. 10, 1966	Received and filed "Designation" issued by Hon. Paul C. Weick, Chief Judge, U.S. Court of Appeals, 6th Circuit, January 7, 1966, designating the following Judges to hear and determine this action: Honorable Harry Phillips, Judge, U.S. Court of Appeals, Honorable Henry L. Brooks, Chief Judge, U.S. District Court, Western District of Kentucky; Honorable James F. Gordon, Judge, U.S. District Court, Western District of Kentucky.
Feb. 24, 1966	Motion for leave to intervene as a defendant filed by American Commercial Lines, Inc. with notice of hearing 3/4/66 at 2 pm. Order and Answer tendered.
Feb. 28, 1966	ORDER dated 2/28/66 permitting American Commercial Lines, Inc. to intervene as an additional party defendant and to file its answer to the complaint, and to otherwise participate in these proceedings. Copies to Attorneys Leigh, Stopher, Blackwell, Helmetag, Martin and Clark.
Feb. 28, 1966	ANSWER of intervening defendant American Commercial Lines, Inc. filed.
March 1, 1966	Motion for enlargement of time filed by U.S. Order tendered.
March 2, 1966	ORDER dated 3/1/66 that the time for filing the defendants' answer is extended from [illegible]/66 to and including 4/5/66. Copies to Attorn[illegible] Leigh, Stopher, Helmetag, Blackwell and Martin (U.S. Atty-Asst)
March 4, 1966	Motion of National Motor Freight Traffic Association, Inc. for leave to intervene as a defendant filed. ANSWER tendered.
March 4, 1966	Motion of Waterways Freight Bureau, Mississippi Valley Barge Line Co., Ohio River Company and

	Union Barge Line Corporation to intervene filed by Robert E. Webb. Order and Answer tendered.
March 10, 1966	ORDER dated 3/10/66 permitting intervention of Waterways Freight Bureau, Mississippi Valley Barge Line Company, Ohio River Company and Union Barge Line Corporation, and filing their ANSWER herein.
Apr. 4, 1966	Motion for extension of 45 days in which to file answer filed by U.S. Atty.
Apr. 5, 1966	Order signed by Judge Gordon 4-5-66 - time for filing answer extended to and including May 20, 1966. Copies to U.S. Atty., Elbert R. Leigh, Joseph E. Stopher, Carl Helmetag, Jr., R. Lee Blackwell, Eli H. Brown, III and Robert E. Webb.
Apr. 11, 1966	ORDER dated 4/11/66 that National Motor Freight Traffic Assn is permitted to intervene in this proceeding, file answer and otherwise participate fully. Copies to Attorneys Catlett, Freund, Rea, Marshall, Ginnane, Rivers, Ames, Leigh, Stopher, Helmetag and Blackwell.
Apr. 11, 1966	ANSWER of intervening defendant Natl Motor Freight Assn., Inc. filed.
May 20, 1966	Motion for enlargement of time filed by U.S. Attorney. Order tendered.
May 20, 1966	ORDER dated 5/20/66 that the time for filing defendants' answer is extended from May 20, 1966, to and including June 20, 1966. Copies to U.S. Attorney and Catlett & Amato, Rea, Cross, Knebel & Kinnaird, Harry C. Ames, Elbert R. Leigh, Joseph E. Stopher, Carl Helmetag, Jr., R. Lee Blackwell, Eli H. Brown, III and Robert E. Webb.
June 20, 1966	ANSWER of Interstate Commerce Commission filed. Filing confirmed on carbon of letter from Leonard S. Goodman, Asst. Gen. Counsel, I.C.C.
June 20, 1966	ANSWER of United States of America - filed, with certificate of service.
June 24, 1966	Motion to Intervene filed by National Truck Carriers, Inc., as deft. - filed. Answer and Order tendered.

July 5, 1966	Order signed by Judge Gordon 7/1/66 permitting National Tank Truck Carriers, Inc. to intervene as deft., with right to file an answer herein. Copies to Mr. Elbert R. Leigh, R. Lee Blackwell, Joseph E. Stopher, Carl Helmetag, Jr., Brown & Eldred, Laroe Winn & Moerman, George M. Catlett, F. G. Freund, Bryce Rea, Jr., Thomas M. Knebel, Robert E. Webb, Harry C. Ames, Nuel D. Belnap, Richard M. Freeman and Daniel J. Sweeney; Robert W. Ginane, Donald F. Turner, E. W. Rivers, 7/5/66.
July 5, 1966	Answer of Intervening Deft. Natl. Tank Truck Carriers, Inc. - filed.
July 12, 1966	Motion to enter the name of T. Randolph Buck, as additional counsel of record for the intervening defendant, American Commercial Lines, Inc. Order tendered.
July 13, 1966	ORDER dated 7/13/66 that the name of T. Randolph Buck, Esq., P.O. Box 610, Jeffersonville, Indiana, be added as additional counsel for the intervening American Commercial Lines, Inc. Copies to attorneys of record.
July 13, 1966	ORDER dated 7/13/66 that the time for filing shall be as follows: (1) Briefs for plaintiffs due 9/6/66, (2) Briefs for defendants due 10/17/66 and (3) Reply briefs of plaintiffs due 11/7/66. Copies to Attorneys Marshall, Katzenbach, Turner, Rivers, Wigger, Martin, Ginnane, Goodman, Ames, Webb, Brown, Martin, Clark, Laroe, Winn & Moerman, Catlett, Belnap, Belnap, Rea, Cross, Knebel & Kinnaird, Feund, Helmetag, Leigh and Buck.
Aug. 23, 1966	Motion of Ann Arbor Railroad Company and Certain Other Railroad Companies for Leave to Intervene in Support of Plaintiffs and Statement of Grounds in Support of Motion of The Ann Arbor Railroad Company and Certain Other Railroad Companies for Leave to Intervene in Support of Plaintiffs filed by R. Lee Blackwell. Order tendered.
Aug. 30, 1966	ORDER dated 8/30/66 that The Ann Arbor Railroad Company and certain other railroad companies are granted leave to intervene in support of plaintiffs, and to brief the issues and otherwise partici-

pate fully in this action. Copies to Attorneys: Elbert R. Leigh, R. Lee Blackwell, Carl Helmetag, Jr., Brown & Eldred, Laroe, Winn & Moerman, Geo. M. Catlett, F. G. Freund, Bryce Rea, Jr., Thos. M. Knebel, Robt. E. Webb, Harry C. Ames, Nuel D. Belnap, Robert W. Ginnane, Donald F. Turner, U.S. Attorney and Dept. of Justice.

Sep. 6, 1966 — Brief of the Railroads filed, with Appendix to Railroads Brief.

Sep. 6, 1966 — Brief for the United States filed with Certificate of Service.

Aug. 30, 1966* — Certain other railroads referred to in order entered 8/30/66: A. T. & SF RR Co., Atlanta and West Point RR Co., Atlantic Coast Line RR Co., B&O RR Co., Central of Ga. Rwy Co., C&O RR Co., Chi., Burl. & Quincy RR Co., Chi. Great Western Ry Co., Chi., Milwaukee, St. P. and Pacific RR Co., Chi. & North Western Ry Co., Chicago, Rock Island and Pacific RR Co., Clinchfield RR Co., Colorado & Southern RR Co., Detroit, Toledo & Ironton RR Co., Denver & Rio Grande Western RR Co., Elgin, Joliet & Eastern Ry Co., Erie-Lackawanna RR Co., Fort Worth & Denver Ry Co., Ga. RR, Ga. Southern & Fla. Ry Co., Grand Trunk Western RR Co., Great Northern Ry Co., Gulf, Mobile & Ohio RR Co., IC RR Co., Lehigh & Hudson River Ry Co., Lehigh Valley RR Co., Maine Central RR Co., Mo-Kansas-Texas RR Co., Mo. Pacific RR Co., NYC RR Co., NY., N. Haven & Hart. RR Co., Norfolk Southern Railway Co., Norfolk & Western Ry Co., Northern Pacific Ry Co., Reading Co., Richmond, Fredericksburg & Potomac RR Co., St. Louis, San Francisco Ry Co., Stl. Southwestern Ry Co., Seaboard Air Line RR Co., Soo Line RR Co., Southern Pacific Co., Southern Ry Co., Texas & Pacific Ry Co., Union Pacific RR Co., Western Maryland Ry Co., Western Pacific RR Co. and Western Ry of Ala.

Sep. 8, 1966 — Motion to substitute corrected brief for the United States filed by U.S. Attorney. Corrected brief tendered.

Sep. 8, 1966 — ORDER dated 9/8/66 setting hearing 1/23/67 at 9:30am. Copies to Attorneys.

Sep. 13, 1966	"Motion of American Trucking Associations, Inc. For Leave To Intervene In Support of Defendant, Interstate Commerce Commission" - filed by counsel for Movant.
Sep. 22, 1966	Order signed by Judge Gordon dated 9-22-66 that the time for filing briefs shall be changed as follows: 1. Briefs for the defendants and any parties in support of the Commission's order will be due on Thursday, November 17, 1966; 2. Reply briefs of the plaintiffs and any parties in support of them will be due on Wednesday, December 7, 1966. Copies mailed to Elbert R. Leigh, Joseph E. Stopher, R. Lee Blackwell, Carl Helmetag, Jr., Brown & Eldred, Laroe, Winn & Moerman, T. Randolph Buck, George M. Catlett, F. G. Freund, Bryce Rea, Jr., Thomas M. Knebel, Robert E. Webb, Harry C. Ames, Robert W. Ginnane, Leonard S. Goodman, Donald Turner, Robt. B. Hummel, John H. D. Wigger, Ernest W. Rivers, U.S. Atty; Bullitt, Dawson & Tarrant, Nuel D. Belnap, J. Raymond Clark.
Sep. 23, 1966	Order signed by Judge Gordon, dated 9-23-66 that on motion of American Trucking Associations, Inc., for leave to intervene in support of defendant, Interstate Commerce Commission, IT IS ORDERED that The American Trucking Associations, Inc., is granted leave to intervene in support of defendant, Interstate Commerce Commission, and to brief the issues and otherwise participate fully in this action. Copies to Thurgood Marshall, Nicholas B. Katzenback, Donald F. Turner, Ernest W. Rivers, John H. D. Wigger, Robt. W. Ginnane, Leonard S. Goodman, Harry C. Ames, Robert E. Webb, Eli H. Brown, R. Lee Blackwell, J. Raymond Clark, Laroe, Winn & Moerman, Nuel D. Belnap, Carl Helmetag, Jr., Elbert R. Leigh, T. Randolph Buck, Harry J. Breithaup, Jr., Joseph E. Stopher, E. G. Freund, Bryce Rea, Jr., Thos. Knebel, Robt. B. Hummel, Bullitt, Dawson & Tarrant.
Sep. 23, 1966	ANSWER of American Trucking Assns., Inc. filed.

Oct. 7, 1966	Motion of the American Waterways Operators, Inc. to intervene as defendant filed with Memorandum of points and authorities in support of motion to intervene. Order and Answer tendered.
Oct. 10, 1966	ORDER dated 10/10/66 that The American Waterways Operators, Inc. is permitted to intervene as a party defendant and to file its answer to the complaint, and otherwise participate in these proceedings. Copies to Attorneys Stopher, ICC, Buck, Leigh, Blackwell, Helmetag, Atty-Gen., U.S. Atty, Brown, Clark, Catlett, Freund, Knebel, Webb, Ames Smith and Layne.
Oct. 10, 1966	ANSWER of intervening defendant The American Waterways Operators, Inc. filed.
Oct. 13, 1966	ORDER dated 10/13/66 that motion of U.S. to file corrected brief in place of brief filed 9/6/66 SUSTAINED. Copies to all parties of record.
Oct. 13, 1966	Corrected brief filed by U.S.
Oct. 14, 1966	Motion of Waterways Freight Bureau, Mississippi Valley Barge Line Co., Ohio River Co. and Union Barge Line Corp. for order postponing due date of briefs; proposed order tendered.
Nov. 14, 1966	Order signed by Judge Gordon 11/14/66 that time for filing briefs to be changed as follows: 1. Briefs for defts. and any parties in support of the Commission's order will be due on Mon. Nov. 28, 1966; and 2. Reply briefs of pffs. and any parties in support of them will be due on Mon. Dec. 19, 1966. Copies to counsel of record mailed 11/14/66.
Nov. 23 1966	Brief for The American Waterways Operators, Inc., intervening defendant, filed.
Nov. 25, 1966	Brief on behalf of Mississippi Valley Barge Line Company; Ohio River Company; Union Barge Line Corporation; and Waterways Freight Bureau; Protestants before the Interstate Commerce Commission and intervening defendants herein - filed.
Nov. 25, 1966	Brief on behalf of American Commercial Lines, Inc., Intervening Defendant, filed.

Nov. 28, 1966	Brief of the Interstate Commerce Commission filed.
Nov. 28, 1966	Brief of American Trucking Associations, Inc., National Motor Freight Traffic Assn., Inc. and National Tank Truck Carriers, Inc. - filed.
Dec. 19, 1966	Reply Brief for the United States filed with Certificate of Service.
Dec. 20, 1966	Reply Brief of the Railroads filed.
Jan. 23, 1967	Interstate Comm. Comm. case No. 28190 filed by Mr. Carl Helmetag, Jr., ICC - investigation and suspension docket No. 7656 - also filed.
Jan. 25, 1967	ORDER signed by Judge Gordon dated 1/23/67 that the Court having heard oral arguments will take the matter under advisement and all parties submit proposed orders within 30 days of this order. Copies to Elbert R. Leigh, Joseph E. Stopher, Carl Helmetag, Jr., R. Lee Blackwell, Hon. Thurgood Marshall, Donald F. Turner, John J. D. Wigger, Robert K. Johnson, Leonel Kestenbaum, Ernest V. Rivers, Wm. B. Martin, Robert W. Ginnane, Leonard S. Goodman, Eli H. Brown, Boyce F. Martin, Jr., T. Randolph Buck, J. Raymond Clark, Geo. M. Catlett, F. G. Freund, Bryce Rae, Jr., Thomas M. Knebel, Robert E. Webb, Harry C. Ames, S. Russell Smith, and A. Alvis Layne.
Feb. 1, 1967	Transcript of proceedings held 1/23/67 filed by C. L. Sterling, Court Reporter.
Feb. 6, 1967	Filed by Court Reporter: Certified copies of (1) Schedule filed with ICC 9/11/64-Supplement 65 to Trunk-Line-Central Territory Railroads Tariff Bureau Etc. (2) Pleadings before ICC in I&S No. 8038, Ingot Molds, Pa., to Steelton, Ky. (3) Transcript of stenographer's notes (same case).
Feb. 23, 1967	Proposed order of the Railroads and the United States tendered with the Certificate of Service filed. Copies forwarded to Judge Phillips, Judge Brooks and Judge Gordon.
Feb. 23, 1967	Proposed findings of fact and conclusions of law filed by I.C.C. and Intervening Defendants.

May 15, 1967 — Judgment signed by Judges Phillips, Brooks and Gordon dated May 15, 1967 - Court having concluded in its opinion (unsigned opinion attached to judgment) that plaintiffs are entitled to judgment, Ordered, adjudged and decreed that the report and order of the Interstate Commerce Commission, entered 12-2-65, be set aside and the ICC hereby enjoined from enforcing it with prejudice. Matter remanded to Commission for reconsideration and such further action as the Commission may deem appropriate, not inconsistent with the opinion this day rendered by this court. Copies of Judgment and Opinion mailed to all counsel of record.

July 12, 1967 — Notice of appeal by American Waterways Operators Inc., to U.S. Supreme Court - filed. Copies of Notice of Appeal mailed 7/12/67 to: Hon. Thurgood Marshall, Solicitor General of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney, Robert W. Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Belnap, Spencer, Hardy & Freeman; James A. Bistline; Stanfield Johnson; J. Edgar McDonald; Thormund A. Miller; Donald L. Turkal; and Gregory S. Prince.

July 13, 1967 — Notice of appeal by Interstate Commerce Commission to U.S. Supreme Court - filed. Copies of Notice of Appeal mailed 7/13/67 to: Hon. Thurgood Marshall, Solicitor Gen. of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney; Robert Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Bel-

	nap, Spencer, Hardy & Freeman; James A. Bistline; Stanfield Johnson; J. Edgar McDonald; Thormund A. Miller; Donald L. Turkal; and Gregory S. Prince and S. Russell Smith.
July 13, 1967	Notice of appeal by American Commercial Lines, Inc., Mississippi Valley Barge Line Company, Ohio River Company, Union Barge Line Corporation and American Waterways Freight Bureau to U.S. Supreme Court - filed. Copies of Notice of Appeal mailed 7/13/67 to: Hon. Thurgood Marshall, Solicitor Gen. of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney; Robert Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Belnap, Spencer, Hardy and Freeman; James A. Bistline; Stanfield Johnson; J. Edgar McDonald; Thormund A. Miller; Donal L. Turkal; Gregory S. Prince; and S. Russell Smith.
July 14, 1967	Notice of appeal by American Trucking Associations, Inc., National Motor Freight Traffic Association, Inc., and National Tank Truck Carriers, Inc., to U.S. Supreme Court - filed.
July 17, 1967	Copies of Notice of Appeal mailed 7/17/67 to: Hon. Thurgood Marshall, Solicitor Gen. Of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney; Robert Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Belnap, Spencer, Hardy & Freeman; James A. Bistline; Stanfield Johnson; J. Edgar Mc Donald; Thormund A. Miller; Donald L. Turkal; Gregory S. Prince; and S. Russell Smith.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

Civil Action No. 5227

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and
THE PENNSYLVANIA RAILROAD COMPANY,
Plaintiffs

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION,
Defendants.

Before the Honorable Harry Phillips, Circuit Judge, and the Honorable Henry L. Brooks and the Honorable James F. Gordon, District Judges.

OPINION

Gordon, District Judge. This suit was brought before this Three-Judge Court, under the provisions of 28 U.S.C. §§ 1336, 2284, 2321-2325, by the Louisville and Nashville Railroad Company and The Pennsylvania Railroad Company to enjoin, annul and set aside an order of the Interstate Commerce Commission in Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965). As required by law, the United States of America was named a defendant, as was the Interstate Commerce Commission.

Some 48 railroads were permitted to intervene as additional plaintiffs in support of the principal plaintiff railroads. Interested and requesting barge lines, truck carriers and related associations were permitted to inter-

vene in support of the defendant, Interstate Commerce Commission.

The United States of America, admitting that "the Order of the Interstate Commerce Commission is invalid", was, for purposes of brief and oral argument, treated as an additional plaintiff.

On January 23, 1967, oral argument was heard before this Court.

In 1953, the Green River Steel Corporation began purchasing ingot molds and stools from the Shenango Penn Mold Company at Neville Island, Pittsburgh, Pa. The shipper's plant at Neville Island is served by the Pennsylvania Railroad in connection with a short-line railroad, and the receiver's plant at Steelton, Kentucky is served directly by the Louisville and Nashville Railroad. Prior to 1965 the barge-truck route received substantially all of this traffic because its charges were below rail charges. The then and present charge for movement by barge-truck being $5.11 per gross ton, minimum 600 gross tons, and the railroad charge then being $11.86 per ton, subject to a carload minimum of 100,000 pounds.

With the stated purpose of enabling them to compete for this traffic, the respondent railroads published, effective December 1, 1963, a reduced rate on ingot molds, from Neville Island and Pittsburgh, Pa., to Steelton, Ky., of $5.11 per ton, when moved in single shipments of not less than 600 gross tons, minimum weight 112,000 pounds per car (12 or fewer cars) on one bill of lading, from one consignor at one origin to one consignee at one destination, with delivery to the originating railroad to be completed on one day. Consignee testimony indicates that if the railroads are to participate substantially in the movement, it will be necessary to have a rail rate not exceeding the total cost to the consignee of handling the ingot molds via barge-motor service.

The Commission found that the railroads' so-called out-of-pocket costs of transporting the ingot molds traffic, when computed by its own Rail Form A formula, would be $4.689 per ton, and substantially less if return on investment were eliminated. Since the reduced rail rate exceeded such costs by 42.1 cents, the Commission found that the rate would be compensatory. The Commission further found that the lower rail rate of $5.11, by attracting greater volume, would produce greater revenues in excess of out-of-pocket costs than would the higher rail rate of $11.86, which formerly had attracted only minimal tonnage, and also that "the railroad out-of-pocket costs are lower than the barge-motor lines' variable (i.e., out-of-pocket) costs". Further, that the railroads' "fully-distributed" costs amounted to $7.594 and the barge-truck "fully-distributed" costs were $5.196. These "fully-distributed" cost calculations were made by adding to the expenses incurred in handling the ingot molds traffic statistical apportionments of the respective modes' constant costs. The constant costs are expenses which are not related or traceable to the handling of any particular item of traffic.

Upon protest of the barge lines, the reduced rail rate was suspended and placed under investigation by the Commission. By voluntary agreement, the suspension period was extended until the matter was determined by Division 2. After Division 2, on February 17, 1965, 323 I.C.C. 758, found the rate to be lawful, the railroads made it effective on March 19, 1965. This rate has remained in effect since that time. Subsequently, December 2, 1965, the entire Commission in its report and order found the rate to be unlawful and ordered it cancelled, 326 I.C.C. 77, but this order of the Commission has been stayed pending consideration of the situation by this Court.

The Commission held that the determination of which mode had the inherent advantage of lower costs in han-

dling the involved ingot molds traffic should be based upon a comparison of the "fully-distributed" costs of the two modes. Upon this comparison, it found that the barge-truck route possessed the advantage of lower costs in transporting ingot molds. It further decided that the reduced rail rate unlawfully "impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage" because the reduced rate was below the level of the "fully-distributed" costs of the barge-truck route. The Commission established the "fully-distributed" costs of the barge-truck route ($5.196) as the floor for the reduced rail rate, although the barge-truck rate of $5.11 was below this level.

The principal statutory provision governing this controversy is Section 15a(3) of the Interstate Commerce Act (49 U.S.C. § 15a(3)), which came into the Act by the enactment of the Transportation Act of 1958, 72 Stat. 572. That Section reads:

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

The National Transportation Policy referred to is the preamble to the Interstate Commerce Act and provides guidance for interpreting the various sections of the Act. In its present form, it became part of the Interstate Commerce Act by the enactment of the Transportation Act of 1940, 54 Stat. 898. It reads:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating and preserving a national transportation system by water, highway and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

Jurisdiction of the subject matter and venue of this action in this Court is conceded by the parties.

Under Section 10(e) of the Administrative Procedure Act, 5 U.S.C. § 1009, the scope of our review of the Commission's order is limited to a determination of whether the order is arbitrary or not in accordance with the law, and whether the Commission's findings are supported by substantial evidence. An order is arbitrary within the meaning of the Administrative Procedure Act if it lacks a stated rational basis. See *Gilbertsville Trucking Co.* v. *United States*, 371 U.S. 115, 126 (1962); *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 167-68 (1962); *Eastern Central Motor Carriers Ass'n* v. *United States*, 239 F.Supp. 591, 594 (D. D.C. 1965). It is not in

accordance with the law within the meaning of Section 10(e) if it is based upon an erroneous interpretation or misapplication of relevant statutory provisions. See *St. Louis-San Francisco Ry. Co.* v. *United States*, 207 F.Supp. 293, 295 (E.D. Mo. 1962); *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 631-33 (E.D. Mo. 1962). While the determinations of an administrative agency are normally entitled to considerable deference upon review, *cf. East Texas Lines* v. *Frozen Food Express*, 351 U.S. 49, 54 (1956), and orders of the Commission which satisfy the requirements stated above are not to be disturbed on review even though the Court might reach a different result on the record, "it is not the function of a court sitting in such review merely to apply a rubber stamp of approval regardless of whether or not the criteria for affirmance are established by the record". *Cincinnati, N.O. & T.P. Ry. Co.* v. *United States*, 229 F.Supp. 572, 575 (S.D. Ohio 1964), vacated *sub. nom. Arrow Transp. Co.* v. *Cincinnati, N.O. & T.P. Ry. Co.*, 379 U.S. 642 (1965).

We have concluded that the Commission's order must be set aside, *first*, because it lacks a rational basis and thus is arbitrary and, *second*, because it is inconsistent with the objectives and purposes of Congress in enacting Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. § 15a(3), and thus is not in accordance with law.

In disapproving the proposed reduced rate of the railroads, the Commission appears to us to be plainly holding up the railroad rate "to protect the traffic" of another mode. It argues, however, that the National Transportation Policy, to which it is commanded to give "due consideration" by the same provision, compels this result. It relies specifically on the requirement that the Act be administered to "recognize and preserve the inherent advantages of each (mode of transportation)".

In *Interstate Commerce Comm'n* v. *New York, N.H. & H.R.R. Co.*, 372 U.S. 744, 760-61 (1963) (referred to hereafter as *New Haven*), the Supreme Court specifically left open the question which is raised in this proceeding. The Court said:

> It is not for us to make this determination at this stage, or to decide in advance precisely how either carrier's inherent advantages should be measured or protected. It may be, for example, that neither a comparison of 'out-of-pocket' nor a comparison of 'fully-distributed' costs, as those terms are defined by the Commission, is the appropriate method of deciding which of two competing modes has the cost advantage on a given movement . . . . These and other similar questions should be left for initial resolution to the Commission's informed judgment. (372 U.S. at 760-61)

This is the first case following *New Haven* in which a court has been called upon to review a determination by the Commission of how the inherent advantages of competing modes of transportation should be recognized or preserved. Since there are no directly controlling court precedents, it is for this court to determine whether the Commission's order properly implements the objectives and purposes of the Congress in enacting Section 15a(3).

We hold, first, that the Commission has failed to state a rational basis to support its conclusion that the "fully-distributed" costs of the two competing modes must be compared to determine which mode has an inherent cost advantage. In support of this conclusion, the Commission states:

> We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for

transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, *does not necessarily mean that the carrier is the more efficient of the two.* Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve. (326 I.C.C. at 82) (Emphasis added)

The language we have just quoted contains the only statement in the Commission's opinion in which it refers to the question of the relative efficiency of the competing carriers in carrying this traffic. This question is one of great importance in view of the Commission's obligation, declared in the National Transportation Policy and the ratemaking provisions of the Act, to promote efficient and economical use of transportation resources and the establishment of rates which are as low as possible. The importance of these considerations has been underscored repeatedly by the courts. Thus, the Supreme Court in *New Haven* emphasized the Congressional policy to promote "hard competition" (372 U.S. at 759). In *St. Louis-San Francisco Ry. Co.* v. *United States*, 207 F.Supp. 293, 298-99 (E.D. Mo. 1962), the court emphasized the obligation of the Commission to consider "the need, in the public interest, of adequate and efficient transportation service at the lowest cost consistent with the furnishing of such service".

The Commission states that: "Merely because a carrier is able, without incurring an out-of-pocket loss, to handle

certain traffic at rates below fully-distributed costs and by gaining added traffic maximize the contribution which such traffic makes to its overhead, does not necessarily mean that the carrier is the more efficient of the two" (326 I.C.C. at 82). Are we not entitled to ask *in what circumstances*, if any, would the carrier with lower out-of-pocket costs be *less efficient*? Are we not entitled to some explanation *why the standard* chosen by the Commission *measures* which carrier is more efficient in providing the service here involved? On the basis of the Commission's report, we are left completely in the dark on these matters.

The Commission's failure to explain how its approach for recognizing and preserving the inherent advantages of the different modes of transportation promotes the most efficient and economical use of transportation resources is particularly wanting since the record before it contained testimony addressed to this question; though the Commission was not bound to accept same, such did at least, we think, make it necessary for the Commission to set forth adequate reasons to support its own approach. Such reasons are lacking in the Commission's report.

For example, the record indicates that one of the constant expenses which is included in the railroads' "fully-distributed" costs is an allocated share of the deficits (very substantial in amount) incurred by the railroads in providing passenger and less-than-carload services.

The barge lines and motor freight carriers do not provide passenger services. Is it unrealistic in comparing the relative efficiency of the two modes, to include as a part of the railroads' costs these deficits? Is it equally unrealistic in determining which mode is more efficient, to include any other constant expenses in the costs being compared, since these expenses, like the passenger deficits,

are not related to furnishing the particular service? The Commission no where comes to grips with these questions, nor does it set forth its own analysis in making its determination.

In its statement supporting its conclusion hereinabove, the Commission also says that, "In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs." This statement reflects the Commission's use of an out-of-pocket cost comparison to determine which of the competing modes has an inherent advantage in situations where there is substantial competition from unregulated carriers. In such situations, the Commission finds a reduction lawful if it exceeds the proponent carrier's out-of-pocket costs. See *Grain in Multiple-Car Shipments—River Crossings to the South*, 321 I.C.C. 582 (1963).

The Commission leaves unexplained its use of different pricing floors *depending upon whether a reduced rate* is intended to meet *regulated* or *unregulated* competition.

We believe that the reasons given by the Commission in the Southern Grain case to support its conclusion that the public interest is fostered by permitting a regulated mode to compete with nonregulated lawful carriers, by offering reduced rates which exceed out-of-pocket costs, logically would seem to apply equally where competition is between two competing regulated modes.

Likewise, we reject as adequate support for the Commission's decision here, its finding that since railroad out-of-pocket costs are lower than barge-motor line variable costs, the former could wage a longer rate battle than the latter, with the Commission powerless to intercede and halt such devastation, all to the prejudice of recognition and preservation of inherent advantage as contemplated

by national policy. The Commission's power to disapprove non-compensatory rates and prevent destructive competition is firmly established. Such an argument that the consequence of a rate reduction below fully distributed costs would leave the Commission powerless has heretofore been rejected. *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 635 (E.D. Mo. 1962).

Citations by the Commission of several prior decisions in which it compared "fully-distributed" costs to determine which mode had an inherent advantage contain no further explanation to support such a standard, although not determinative, we note that the Commission has not consistently employed a "fully-distributed" cost standard. For example, in one recent case, *Roasted Coffee and Coffee Extracts From Texas Gulf Ports to Texas*, 314 I.C.C. 675, 680 (1961), the Commission says, "It would be inconsistent with the national transportation policy to prohibit the respondents from establishing competitively necessary rates which are shown to be compensatory." And see *Paint and Related Articles in Official Territory*, 308 I.C.C. 439 (1959); *Fresh Meats, Transcontinental, Westbound*, 309 I.C.C. 529, 544 (1960); *Prue Motor Transp. Inc.* v. *Boston & Maine R.R.*, 316 I.C.C. 299, 302 (1962). *Cf. Iron Ore, Cleveland, Ohio to Ohio and Pennsylvania*, 323 I.C.C. 746, 754 (1965), complaint dismissed, *Baltimore & Ohio R.R. Co.* v. *United States*, 249 F.Supp. 712 (W.D. Pa. 1965), aff'd *per curiam* 385 U.S. 3 (1966).

The Commission also relies upon the decision of the Supreme Court in *New Haven*. We have previously pointed out that the Supreme Court there specifically left open for later decision the question which is presented in this proceeding, after making it clear that this question was not before it (372 U.S. at 749-50). As we read the Supreme Court's opinion, it held that the Commission

cannot, under Section 15a(3) and the National Transportation Policy, find unlawful the reduced rate of one mode merely because it would divert some or even all of the traffic from a competing mode. As the Court said:

> If there is one fact that stands out in bold relief in the legislative history of § 15a(3), it is that Congress did not regard the setting of a rate at a particular level as constituting an unfair or destructive competitive practice simply because that rate would divert some or all of the traffic from a competing mode. (372 U.S. at 759)

The Court also said that a reduced compensatory rate should not be found unlawful unless this is necessary to preserve the inherent advantages of a competing mode (372 U.S. at 758). And it added:

> If a carrier is prohibited from establishing a reduced rate that is not detrimental to its own revenue requirements merely because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service. (372 U.S. at 759)

We note that in the situation before us the Commission found not only that the reduced rail rate would be compensatory, but that it would produce greater revenues in excess of out-of-pocket costs than would the former higher rate. The reduced rate therefore will not be detrimental to the railroads' revenue requirements. In these circumstances and in light of the inadequacy of the Commission's report with respect to the recognition and preservation of inherent advantages, we are of the belief that *New Haven* provides no support for the Commission's order.

We also hold that the Commission has failed to state a rational basis to support its selection of the "fully-

distributed" costs of the barge-truck mode as the floor for reduced railroad rates. The Commission said:

> In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. Cf. *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567, 575-579 (1947); *Dixie Carriers, Inc.* v. *United States*, 351 U.S. 56 (1956). (326 I.C.C. at 85)

How does the reduced railroad rate deprive shippers of cheaper water transportation? It appears to us to only provide shippers with an alternative form of transportation at an equivalent rate. The decisions cited by the Commission furnish no support for its conclusion, since none was concerned with Section 15a(3) or the setting of minimum rate floors. In *Mechling*, railroads carrying grain from Chicago to Eastern cities were charging more for carrying grain which arrived in Chicago by water carrier than for grain which arrived by rail. The Supreme Court upheld the Commission in finding that this action discriminating against water carriers violated § 3(4) of the Act. In *Dixie Carriers*, the railroads had refused to establish a joint rail-barge rate between two points in Texas. The Supreme Court held that this refusal constituted a discrimination in rates between connecting lines prohibited by § 3(4) of the Interstate Commerce Act, and that the Commission had a duty under § 307(d) to establish through routes and joint rates for rail-barge transportation. No such issue of discrimination is presented here.

We cannot escape the conclusion that the ultimate finding that the rates in issue are not just and reasonable

was motivated by the Commission's desire to prevent any rate competition which threatens the continued existence of a competitor. In support of its determination to employ a comparison of "fully-distributed" costs to determine which mode possesses an inherent advantage, the Commission stated its belief that "an inherent cost advantage under the National Transportation Policy reasonably could not embrace a concept that would impair the ability of a carrier not only to compete but to exist" (326 I.C.C. at 82). This rationale is directly in conflict with the conclusion of the Supreme Court in *New Haven*. (See our last above quote of the Court from that case.)

It is our belief that the Commission's order is based upon a misinterpretation or misapplication of the relevant statutory provisions. We gain support from the legislation itself, its history, and its application in other recent cases. In *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 633 (E.D. Mo. 1962), a three-judge District Court stated:

> "As far back as 1945, in the case of New Automobiles in Interstate Commerce, 259 I.C.C. 475, the Commission had said, l. c. 538:
>
> > 'As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, *there appears to be no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa.*' (Emphasis added)

In spite of these words, the Commission had, in a line of cases through the early 1950's, often canceled reduced rates, though they were fully compensatory.

> While the Commission has traditionally contended that such cancellations were not ordered to protect other modes, the Congress felt otherwise, and enacted Section 15a(3) at least in part as a direction to the Commission to treat competitive rate cases in a manner consistent with the language and spirit of New Automobiles."

We do not think there can be any doubt that the underlying purpose of Congress in enacting Section 15a (3) was to direct the Interstate Commerce Commission to observe the original intent of Congress in 1940 and to restore and adhere to the policy set forth in *New Automobiles* with respect to the preservation of inherent advantages. Both the Senate and House Committee Reports are explicit on this matter,[1] and there were also

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[1] The Senate Report, after stating it "agrees with and wishes to emphasize the import of" the Senate Subcommittee report, quotes the following from it:

> It nevertheless appears that the Interstate Commerce Commission has not been consistent in the past in allowing one or another of the several modes of transportation to assert their inherent advantages in the making of rates. The subcommittee recommends, therefore, that the Commission consistently follow the prinpicle of allowing each mode of transportation to assert its inherent advantages, whether they be of service or of cost. In 1945 in New Automobiles in Interstate Commerce (259 I.C.C. 475), the subcommittee believes that the Commission properly construed the intent of Congress in this respect when it said:
>
> > 'As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, there appears no warrant for believing, that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa' (259 I.C.C. at p. 238).
>
> The subcommittee wishes to affirm the interpretation of the Commission given in the Automobile case epitomized in the words quoted above. The subcommittee therefore believes it

repeated statements of such an intent in the hearings and debates on Section 15a(3).[2] See *Interstate Commerce Comm'n* v. *New York, N.H. & H. R.R. Co.*, 372 U.S. 744, 755-56 (1963).

There are indications that Congress believed the National Transportation Policy would not prevent carriers from establishing rates which exceeded out-of-pocket costs in the kind of situation here presented. For example, Congressman Wolverton, who was a member of the House Commerce Committee, which reported the bill, said that: "If each mode of transportation is permitted to have rates not below a compensatory figure so that competition can really exist, I think you are then preserving the rights, the inherent rights of each."[3] Congressman O'Hara, another member of the House Commerce Committee, stated that: "If [one] mode of transportation has a compensatory rate and it is lower than that of the competitor, the Interstate Commerce Commission would have to allow [it] to charge a lower rate." (104 Cong. Rec. 12536)[4] A list of "Decisions of the Interstate Com-

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necessary to amend the act only so as, in effect, to admonish the Commission to be consistent in following the policy enunciated in the Automobile case thus assuring reasonable freedom in the making of competitive rates.

The subcommittee anticipates that the broad effect of this amendment will be to encourage competition between the different modes of transportation to the benefit of the shipping public. S. Rep. No. 1647, 85th Cong., 2d Sess., pp. 2-3.

The House Report is to the same effect. H. Rep. No. 1922, 85th Cong., 2d Sess., p. 14.

[2] See, *e.g.*, 104 Cong. Rec. 10842, 12531, 12532; Hearings on S. 3778 before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 14, 29, 178.

[3] Hearings on Railroad Problems Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., p. 409.

[4] Senators Schoeppel, Lausche and Smathers likewise indicated that compensatory rates should normally be permitted. Hearings

merce Commission in Which the Policy of the New Automobiles Case Has Not Been Followed", which was before Congress in 1958, likewise makes it plain that Congress was concerned about cases in which the Commission had declared reduced rates unlawful, although finding that they were compensatory. See Hearings on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 86-91, 174-175.

In a more general vein, the Committees reporting on the bill emphasized that the chief thrust of the amendment was to encourage competitive ratemaking among the different modes of carriage. The Report of the Senate Committee on Interstate and Foreign Commerce described Section 15a(3) as "designed to encourage competition * * * by allowing each form of transportation * * * full opportunity to make rates reflecting the inherent advantages each has to offer * * *" and it expressed approval of the following language of the Supreme Court in *Schaffer Transportation Co.* v. *United States*, 355 U.S. 83 (1957):

> The ability of one mode of transportation to operate with a rate lower than competing types of transportation is precisely the sort of 'inherent advantage' that the congressional policy requires the Commission to recognize.

S. Rep. No. 1647, 85th Cong., 2d Sess., p. 3; and see H. Rep. Co. 1922, 85th Cong., 2d Sess., pp. 13-15.

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on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 11, 56 and 111. Moreover, we note that Congress specifically rejected a provision which would have prevented carriers from offering rates below fully-distributed costs in cases of inter-modal competition. Senator Lausche indicated that the proposal, if adopted, "would completely negative the purposes and intent of the Congress in 1940 and in 1953 when it declared that the inherent advantages of each mode of transportation shall be preserved in the interest of the public". Hearings on S. 3778, *supra*, p. 26.

We observe that the specific Congressional mandate in 1958 was that the Commission *should henceforth be bound in establishing minimum rates by the original intent of Congress in 1940* and the decision of the Commission in *New Automobiles*. In *New Automobiles* the Commission conducted a general investigation of all rates subject to its jurisdiction applying to the transportation of new automobiles, including rates of various forms of rail, truck and water carriage. The motor carriers, who initiated the proceeding, alleged that rail reductions made on an out-of-pocket basis would deprive them of their inherent advantages which the Commission was obligated to preserve by the terms of the National Transportation Policy (259 I.C.C. 539), and asked the Commission "to lay down the principle that in meeting highway competition the railroads should in no instance go below the fully-distributed rail costs or the truck rates" (259 I.C.C. 530). The railroads, on the other hand, asked that they be left free to meet competition by reducing rates to whatever level was necessary in order to attract traffic, provided their rates exceeded out-of-pocket costs (*Id.* at 532-33).

In determining "the relative fitness of the various agencies of transportation" from a cost standpoint, the Commission there compared the railroads' out-of-pocket costs with the truck "full" costs, after finding that the truck "full" costs were substantially the same as its out-of-pocket costs (259 I.C.C. at 529). Upon this comparison, which essentially was of the two modes' out-of-pocket costs, the Commission found that for shorter distances the motor carriers were the low-cost agency, while for the longer distances the cost advantage was with the railroads. Finding that, "According to the cost studies the rates of the several forms are generally compensatory, except in scattered instances", it held that the rates exceeded a "reasonable minimum level" and were lawful. It defined a compensatory rate as "one which is re-

munerative, i.e., covers the out-of-pocket costs, as hereinbefore defined, of handling the particular traffic under consideration, including a proper return on investment".

Noting that "within reasonable limits the public is entitled to the reduced rates brought by competition", the Commission indicated that its decision carried out the intent of Congress.

Thus, in *New Automobiles*, the Commission indicated its understanding that Congress intended that carriers should normally be free to offer rates which were compensatory. This construction of the National Transportation Policy is clearly supported by the legislative history of the Transportation Act of 1940. Congress not only rejected all proposals which would have prevented carriers from offering compensatory rates which were below fully-distributed costs, including the so-called Miller-Wadsworth amendment,[5] but in so doing it made

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[5] The so-called Miller-Wadsworth amendment to the minimum rate section would have provided:

> In order that the public at large may enjoy the benefit and economy afforded by each type of transportation, the Commission shall permit each type of carrier or carriers to reduce rates so long as such rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all other elements entering into the cost to the carrier or carries for the services rendered. (84 Cong. Rec. 6074)

This amendment was included in the bills originally passed by the Senate and the House (84 Cong. Rec. 6074, 9962, 9977), but the Joint Conference Committee of the Senate and the House, to whom these bills were referred, eliminated it. Following lengthy debate, particularly in the House, as to whether it should be restored, ultimately both the Senate and the House voted not to restore it (86 Cong. Rec. 10193-94, 11766-67). Various other proposals which were advanced to prohibit rates below fully-distributed costs in inter-modal competitive situations were also rejected. See H.R. 2531, 76th Cong., 1st Sess., sec. 41; Hearings on S. 1310 and S. 2016, S. 1869 and S. 2009 Before the Senate Committee on Interstate Commerce, 76th Cong., 1st Sess., p. 698.

> . . . It is unnecessary that each individual rate, in order to be profitable, must bear its full share of all costs, including over-

known its belief that such a restriction on competition would be extremely undesirable both from the standpoint of shippers and from the standpoint of the general public seeking the most efficient use of transportation resources.

For example, in explaining why the Miller-Wadsworth amendment was rejected, Congressman Wolverton, one of the managers of the bill in the House and a House conferee as well as a member of the House Commerce Committee, stated:

> The amendment would not only slow up and seriously hamper all reductions but would absolutely prevent a great many desirable reductions from being made.

We believe that the Commission failed to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs. Moreover, we think the Commission's decision here is inconsistent with its philosophy in *New Automobiles*. The Commission's order is therefore not in accordance with law.

We do not mean to suggest that there may not be situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory. What we do suggest is that Congress has expressed a clear intent that reduced compensatory rates should normally

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head, and produce a reasonable profit above such costs. If a rate is high enough to pay more than out-of-pocket operating expenses, it helps meet some of the constant overhead.

. . . We should do nothing that will unnecessarily prevent or delay rate reductions; strike a blow at the fundamental principle of rate making upon which this country was developed, and obstruct or hinder the free flow of commerce which is so essential to our economic welfare. (86 Cong. Rec. 10190-91)

And see 84 Cong. Rec. 9963, 9970; 86 Cong. Rec. 10179, 10187, 11766-67.

be allowed and that the record here and the Commission's report supply no basic for disregarding that intent.

For the foregoing reasons, the order of the Commission in *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965), is hereby set aside and permanently enjoined and the matter is remanded to the Commission for action not inconsistent with this opinion.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

Civil Action No. 5227

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and
THE PENNSYLVANIA RAILROAD COMPANY,
Plaintiffs,

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION,
Defendants.

JUDGMENT

This cause having been heard on the plaintiffs' complaint seeking to enjoin, set aside and annul a report and order of the Interstate Commerce Commission, dated December 2, 1965, in a proceeding styled Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965); and the parties appearing by counsel having been heard and the issues duly tried; and the Court having concluded in its opinion that plaintiffs are entitled to judgment:

It is hereby Ordered, Adjudged and Decreed that the above described report and order of the Interstate Commerce Commission, entered December 2, 1965, be set

aside and the Interstate Commerce Commission is hereby enjoined from enforcing it with prejudice. The matter is remanded to the Commission for reconsideration and such further action as the Commission may deem appropriate, not inconsistent with the opinion this day rendered by this court.

Issued at Louisville, Kentucky, this 15th day of May, 1967.

/s/ Harry Phillips
HARRY PHILLIPS
United States Circuit Judge

/s/ Henry L. Brooks
HENRY L. BROOKS
United States District Judge

/s/ James F. Gordon
JAMES F. GORDON
United States District Judge

A Copy: Attest

MARTIN R. GLENN, Clerk

By /s/ Loraine Milly
Deputy Clerk

Statutes Involved

SECTION 15a(3) OF THE INTERSTATE COMMERCE ACT (49 U.S.C. § 15a(3))

In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

NATIONAL TRANSPORTATION POLICY (49 U.S.C., preceding §§ 1, 301, 901, and 1001)

It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discrimination, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions; all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

Investigation and Suspension Docket No. 8038

INGOT MOLDS, PA., TO STEELTON, KY.

Decided February 2, 1965

Proposed multiple-car rate, minimum 600 gross tons, on ingot molds and ingot mold stools from Neville Island and Pittsburgh, Pa., to Steelton, Ky., found just, reasonable, and otherwise lawful. Proceeding discontinued.

Carl Helmetag, Jr., and *E. R. Leigh* for respondents.

Harry C. Ames and *Wesley A. Rogers* for protestants.

REPORT AND ORDER OF THE COMMISSION

DIVISION 2, COMMISSIONERS FREAS, TUCKER AND TIERNEY

FREAS, *Commissioner:*

By schedules filed to become effective on December 1, 1963, the respondent railroads [1] proposed to establish a reduced rate [2] on ingot molds and ingot mold stools,[3] both herein called ingot molds, from Neville Island and Pitts-

[1] The Pennsylvania Railroad Company and the Louisville and Nashville Railroad Company, hereinafter called the Pennsylvania and the L. & N., respectively.

[2] Rates, differences in rates, costs, and charges are stated per gross ton of 2,240 pounds, unless otherwise indicated.

[3] An ingot mold is a cast-iron form in which molton steel is cast in making ingots. The stool is the base upon which open-bottom molds stand.

burgh, Pa., to Steelton, Ky., of $5.11 when moved in single shipments of not less than 600 gross tons, minimum 112,000 pounds per car (12 or fewer cars), on one bill of lading, from one consignor at one origin to one consignee at one destination, with delivery to the originating railroad to be completed on one day. Upon protest of the Waterways Freight Bureau, the operation of the schedules was suspended to and including June 30, 1964, and an investigation was instituted. The effective date of the schedules has been voluntarily postponed to and including March 31, 1965. Evidence was submitted at the hearing by the respondents in support of the proposed rate, and in opposition thereto by the aforementioned bureau and certain of its members,[4] collectively called protestants. Due and timely execution of our functions under section 15(7) of the Interstate Commerce Act imperatively requires the omission of recommended report and order in this proceeding.

The ingot molds involved herein move principally by barge in connection with truck delivery from the producing plant of the Shenango Penn Mold Company at Neville Island, located in the Pittsburgh port area, to the Green River Steel Corporation at Steelton, 3.5 miles from the Owensboro, Ky., river-rail terminal where barge facilities are located. The shipper's plant is served by the Pennsylvania in connection with the short-line railroad, the Pittsburgh, Chartiers & Youghiogheny Railway Company, hereinafter referred to as the P. C. & Y., and the receiver's plant is served directly by the L. & N.

The proposed rate of $5.11 is equal to the overall charges to the receiver for the barge movement. The latter consist of a barge rate of $3.32, minimum 600 gross tons, a barge-to-truck transfer charge of 95 cents

[4] Mississippi Valley Barge Line Company, Ohio River Company, and Union Barge Line Company.

at Owensboro, and the for-hire truck charge of 84 cents for the movement from Owensboro to Steelton. The present rail rate is $11.86,[5] subject to a carload minimum of 100,000 pounds.

From 1953, following the completion of the receiver's plant at Steelton, to the present time, the movement has been almost exclusively by barge. From 1953 to 1963, the barge rates have increased from $2.84 to $3.32, and the minimum has increased from 500 to 600 gross tons. Notwithstanding the increased minimum weight and rate, net tonnages of 3,878, 4,320, and 5,017 in 1961, 1962, and 1963, respectively, indicate a steady rise in the volume of this traffic moving by barge in recent years. During the first 3 months of 1964, the barge tonnage was 1,500. Barge shipments, on the average, exceed 600 tons. Analysis of systemwide revenues for bureau members for 1962 indicates that iron and steel, which includes class 579 in which the carriers report ingot molds for statistical purposes, is the third most important commodity group transported in barge service, accounting for 10.81 percent of total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of total barge traffic.

In 1953, the rail rate was $13.50, minimum 50,000 pounds. In 1958, it reached a high of $16.72, same minimum, before it was reduced to $12.52, minimum 100,000 pounds. Subsequently, it was reduced to the present rate of $11.86.

The stated purpose of the instant proposal is to enable the respondents to compete for this traffic. Rail shipments have been limited to isolated instances when the receiver's production schedules have required special orders of certain kinds of ingot molds. For example, in 1962 the railroads moved two shipments aggregating 112

[5] This is a conversion of the rate per net ton of $10.59, shown in the tariff, to a gross-ton basis.

net tons; in 1963, five shipments aggregating 276 net tons; and during the first 3 months of 1964, two shipments aggregating 116 net tons. Consignee testimony indicates that if the railroads are to participate substantially in the movement it will be necessary to have a rail rate not exceeding the total cost to the consignee of the present method of handling the ingot molds via barge-motor service.

COST CONSIDERATIONS

Cost studies were submitted by the respondents and the protestants. They are discussed in detail in the appendix hereto. As stated therein, the respondents computed out-of-pocket costs as 483.5 cents, utilizing eastern district and southern region costs based on railroad cost scales by territories for the year 1961, contained in public statement No. 5-63 prepared by our cost finding section, and as 468.9 cents, by the application of Rail Form A to operating data of each respondent for the year 1962. Excluding return on investment, the respective costs are shown as 432 and 419 cents. Fully distributed costs are shown as 759.4 cents.

The protestants restated the respondents' statement No. 5-63 costs as 505.8 cents on an out-of-pocket basis, and 785 cents on a fully distributed basis. They also compute the average rail full cost by various methods as 759.4, 617.1, 687.9, and 564.3 cents. These methods are described in the appendix hereto, and the differences in the out-of-pocket and fully distributed costs as computed by the respondents and the protestants are also discussed therein.

Recognizing that costs are not always ascertainable with mathematical precision, we have found in the appendix hereto that the rail out-of-pocket costs reasonably approximate 468.9 cents, as shown by the respondents upon individual application. Eliminating return on in-

vestment,[6] they would be substantially lower. The rail fully distributed cost figure of approximately 759 cents is reached in a manner consistent with recognized procedures if the use of territorial averages is accepted. Having found the costs upon individual application to be more appropriate however, those on a fully distributed basis would be somewhat lower than 759 cents. We therefore find that the proposed rate exceeds the respondents' out-of-pocket costs, but is below their fully distributed costs:

The protestants, based on the Commission cost section's new Barge C formula, compute the cost of transporting this traffic by the Mississippi Valley Barge Line Company. The record fails to demonstrate, however, that those costs are reasonably representative of the costs of all protestants of record. In any event, when the aggregate charges of $1.79 for barge-to-truck transfer and for-hire trucking are included,[7] the full costs are computed as 535.68 cents, based on an operating ratio for that bargeline of 87.9 percent (the company's average for the last 3 years), and as $5.1959, including a return on investment of 4 percent. To compare validly with rail fully distributed costs, use of the latter figure is more appropriate.

Four transportation economists testified in respondents' behalf to the effect that incremental or out-of-pocket cost, rather than fully distributed cost, is the proper basis both for establishing pricing floors and also for determining the most economic form of transportation. They urge that no meaningful comparison of full costs can be made in this proceeding because of the dissimilarity between the rail and water cost formulas in allocating overhead

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[6] *Cf. Coal from Southern Mines to Tampa and Sutton, Fla.*, 318 I.C.C. 371; *Baltimore & O. R. Co.* v. *Chicago & E. I. R. Co.*, 322 I.C.C. 572.

[7] See *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 784, 785.

costs to the traffic involved. They further contend that only in competitive situations between regulated modes has the use of fully distributed costs ordinarily been found controlling, and that there is no sound justification for such usage.

Service Considerations

Protestants contend that the bargelines are disadvantaged at a parity of charges because of inferior service, and cite the loss of other traffic when differentials were eliminated. However, a comparison of the services indicates that loss and damage has not been experienced on the barge movement and the consignee anticipates none on the rail movement. The rail line-haul service is faster. Nevertheless, considering that plant facilities are adequate to receive shipments of 600 gross tons and the movement is primarily to stockpile, the advantages of faster rail service are not material to consignee. The consignor bears the cost, and must arrange, for the movement of the traffic from its mill to the barge dock and for loading the traffic into the barge. The rail service is door to door, but the intraplant switching of rail cars is performed by the consignee in its equipment and at its expense. It is protestants' position that they can only participate in this traffic when the cost to the shipper is less than all-rail service.

General Discussion and Ultimate Conclusions

For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the Nation's transportation system is to be healthy. Thus, whenever competive carriers of different modes assert cost advantages inherent to their respective modes, we have recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is

reasonably practicable to apportion. Difficulties of apportioning constant costs do prevail. See *Grain in Multiple-Car Shipments—River Crossings to So.*, 321 I.C.C. 582, 597, reversed on other grounds in *Cincinnati, N. O. & T. P. R. Co.* v. *United States*, 220 F. Supp. 46 (S. D. Ohio 1963), appeal docketed, U. S. July 29, 1964, (No. 545). Since constant costs are not directly related to service units, they are assigned on an average statistical basis. In our opinion, however, that assignment does not detract from their worth.[8] We adhere to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented. Stated differently, we recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced herein by respondents ignores them. We decline to so limit our ratemaking powers.

However, a determination that the advantage of low cost lies with one mode or another does not end matters. Nor is such a determination necessarily to be equated with the appropriate rate level. We are not bound by a mechanical formula. Rather, it must be found that a competing rate is destructive of such an advantage. A finding to this effect must of necessity rest with the facts and circumstances in each case.[9] Here, it cannot be controverted that protestant bargelines have chosen for some time to forego the revenues of a rate set at a level which would return fully distributed costs. They have done so voluntarily and, considering the rail rate levels and the fact that the traffic has moved almost exclusively by barge since 1953, without being subject to any compe-

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[8] Compare our action in divisions cases under section 15(6) in *Louisville & N. R. Co.* v. *Southern Ry. Co.*, 319 I.C.C. 639, 660, sustained in *Carolina & N.W. Ry. Co.* v. *United States*, 230 F. Supp. 581 (W. D. N. C. 1964), appeal docketed, U. S. Nov. 16, 1964.

[9] *Cf. Reduced Transcontinental Lumber Rates, 1961*, 318 I.C.C. 815, 844.

titive compulsion insofar as respondents are concerned.[10] From all that appears of record, protestants' choice in setting their rate at the level respondents now seek merely to meet was also reached voluntarily. Such action affords no basis for assuming that the action of respondents in meeting but not undercutting protestants' rate destroys an inherent cost advantage. Indeed, we think it plain that protestants, being in a position of their own free choosing, cannot successfully object to a rate which, we find, will return revenues reasonably in excess of out-of-pocket costs and which is designed merely to meet competition with its resulting benefit to the shipping public. It is well to note as to shippers that there is a public interest aspect in reductions to be achieved through competitive rate making which we are required to recognize in addition to the revenue considerations of the respective modes. Moreover, the proposed rate reasonably appears to be designed to contribute in the aggregate to the constant costs and will afford respondents the opportunity to utilize equipment more fully thereby reducing unit costs. This is so despite protestants' assertion that respondents received greater revenue in excess of out-of-pocket costs under the present $11.86 rate in 1963 in handling five carloads of the involved traffic than they would if they had secured, under the proposed rate, the entire 1963 tonnage which moved by barge and rail. A contrary and more accurate result obtains when the costs we have found appropriate herein (468.9 cents) are utilized. Moreover, the steady rise in traffic movements in 1961, 1962, and 1963 permits an inference that greater tonnage will be available for future movements. Finally,

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[10] The last-mentioned factor in particular, as well as those discussed hereinafter, clearly distinguishes the instant proceeding from the situations presented in *Grain from Idaho, Oreg. & Wash. to Ports in Oreg. & Wash.*, 319 I.C.C. 534 (since reopened for further hearing), and *Pig Iron, Buffalo, N. Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121.

we see no basis for limiting respondents to what are in actuality isolated movements on special orders which may or may not occur again, or to subject the receiver to the much higher charges in such instances. In view of the foregoing, we find the proposed rate compensatory, and just and reasonable. It may readily be inferred that protestants would have raised their rate to a higher level heretofore had they themselves deemed it appropriate to protect their inherent advantage. However, their realization of what we must assume in the circumstances to be a profitable level of revenue at lower rates negates any sound basis for finding destructive competition or a tendency thereto. Indeed, the record impels the conclusion that protestants' cost advantage is such that they are in a position to continue to compete effectively and still charge a rate reasonably in excess of out-of-pocket costs, *cf. Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 761, n. 14 (1963), hereinafter called the *New Haven* case, even if they were to reduce their rate. Stated in another manner, the situation presented is one permitting the reasonable play of competition. *Cf.* Testimony of then Chairman Freas in Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce on Problems of the Railroads, 85th Cong., 2d sess., pt. 3, at 1884 *passim* (1958).

Service considerations as to the involved movement are not shown of record to be controlling. For example, stockpiling and adequate storage space do not necessitate faster service as such. In addition, certain aspects of the two services may be said to be largely offsetting. In this regard, the consignor must arrange for the movement to, and loading on, the barge when such service is utilized. Initially, it is not urged nor is it shown that this service factor and the absorption of the attendant costs by the consignor influence the routing of the traffic. *Cf. Penn-*

sylvania R. Co. v. *United States*, 202 F. Supp. 584 (E. D. Pa. 1962). As an offsetting factor, the consignee is required to perform intraplant switching in its own equipment at its expense. In any event, even assuming inferiorities in protestants' service, there would be corresponding advantages in that of respondents. The national transportation policy is directed to a recognition and preservation of inherent advantages.

In the circumstances presented, we find for the encouragement of lawful competition and conclude that the proposed rate is just and reasonable, and, consistent with the Court's evaluation of section 15a(3) in the *New Haven case*, not destructively competitive.

COMMISSIONER TUCKER concurs in the result.

It is ordered, That this proceeding be, and it is hereby, discontinued.

By the Commission, division 2.

BERTHA F. ARMES,
Acting Secretary

(SEAL)

APPENDIX

RESPONDENTS' COST STUDIES

The respondents submitted four cost studies. Two studies were based upon eastern district and southern region out-of-pocket costs, as shown in I.C.C. Statement No. 5-63. The other two are hereinafter referred to. The respondents also computed fully distributed costs using the eastern district for the Pennsylvania portion of the haul and the southern region for the L. & N. portion of

the haul. These fully distributed costs amounted to 759.4 cents per gross ton.

Territorial studies.—In their cost studies based on Statement 5-63, respondents applied territorial unit costs based on 50 gross tons per car, 600 gross tons per shipment, or a 12-car block with territorial average empty returns in order to reflect what they suggest to be the greatest cost anticipated from this movement.

For the purposes of the above cost studies, the P. C. & Y. and the Pennsylvania costs are based on eastern district out-of-pocket unit costs; and the L. & N. costs are based on southern region out-of-pocket unit costs. The cost study for the southern region was on the same basis as that for the eastern district.

The following are the out-of-pocket costs developed in these studies by respondents in transporting the traffic by rail;

	Total out-of-pocket costs	
	Including return on investment	Excluding return on investment
	(In cents per gross ton)	
P.C. & Y.-Pennsylvania costs based on eastern district Rail Form A (1961)	338.3	304.0
L. & N. costs based on southern region Rail Form A (1961)	145.2	128.0
Total	483.5	432.0

The respondents used the short routes of movement from Neville Island, Pa., to Duffs Junction or Scully, Pa., over the P. C. & Y. plus the movement beyond, over the Pennsylvania, to the latter's interchange point with the L. & N. at Cincinnati, Ohio. This movement involved 311 miles, 7 miles over P. C. & Y., and the remainder over the Pennsylvania.

The multiple-car shipment would be picked up at the interchange point by through train PMC-3 moving from Pitcairn Yard on the Pennsylvania to Columbus, Ohio. At Columbus it would be switched into train CIN-1 for movement to Cincinnati. From this point to Steelton, Ky., movement would be over the L. & N. for a distance of 220 miles. The entire movement would total 531 miles.

The respondents stated that since the P. C. & Y. was a class II railroad, there was not available any cost data relative to its operation. For the 7-mile movement by that carrier from Neville Island to Duffs Junction respondents used the origin terminal, way train, and interchange cost for the eastern district. Also, because this was a proposed movement it was not possible to develop any savings on the P. C. & Y. relative to billing costs and switching time; therefore, eastern district averages were used.

The movement from the interchange point at Scully to Cincinnati was costed on the basis of using the eastern district costs for the movement over the Pennsylvania.

As to switching operations, the respondents did not make any time study to the origination of a car but instead used the average eastern district switching minutes. They allowed 15.29 minutes each to place the empty car and remove the loaded car. These 15.29 minutes were, in turn, multiplied by 12 cars which totaled to 183.5 minutes. To place empties and remove loaded cars, the respondents, therefore, allowed 367 minutes. This operation was estimated to be 6 hours.

At the interchange point there were 7.65 minutes average per car for 12 cars. The interchange costs were increased for empty return movement; and the empty return ratio on gondola cars for the eastern district was used (74 percent). The respondents added 67.9 minutes

to handle the empties, and the total at the interchange point was given as 159.7 minutes.

For intertrain and intratrain switching, which respondents used at Columbus, the average per car was 4.59 minutes; this, in turn, was multiplied by 12 which resulted in 55.1 minutes. The above minutes were increased by the empty return ratio of 74 percent resulting in 95.9 minutes for switching at Columbus. This operation involved the handling from train PMC-3 to train CIN-1. Since the considered traffic was not moving in multiple cars, the respondents relied upon averages and these averages, they claim, overstated the movement.

Individual applications.—The respondents' other two cost studies were based on individual applications of Rail Form A for the Pennsylvania and the L. & N. for the year 1962. The individual application of Rail Form A formula for the Pennsylvania was developed for two purposes, one to show that the costs developed under Rail Form A are comparable to the eastern district costs with respect to the Pennsylvania costs; and secondly, as the respondents did not have available eastern district costs for the year 1962, the individual Rail Form A study was presented in substitution. Thus, the movement from the interchange point at Scully to Cincinnati was costed by applying cost factors developed under Rail Form A prepared for the Pennsylvania. Eastern district average origin terminal, way train, and interchange cost was applied for the move over the P. C. & Y.

The L. & N. also applied the individual application of Rail Form A formula for the year 1962. The purpose of its application is the same as that mentioned above for the Pennsylvania. The former also made adjustments of the interchange switching at Cincinnati (Decoursey Yard) with the Pennsylvania.

There was some doubt expressed by protestants regarding the switching at Decoursey Yard as to whether trains No. 75 and No. 158, used for this transportation beyond Cincinnati, were way trains or through trains, because some switching might be involved. This respondent stated that these trains are different from a way train or so-called local train in that they do no switching en route, while a local freight does. However, a through train may at certain points have a setoff of cars for business purposes but there is no switching involved. The L. & N. maintains that it should not take more than 25 minutes to set off cars at the Steelton plant.

The interchange switching at Cincinnati with the Pennsylvania was adjusted to reflect the cost resulting from this move. The cost per carload as shown by the L. & N. is $4.63. Also, intermediate switching at Louisville, Ky., has been adjusted to 40 percent of the average intermediate switching cost. This results in an intermediate switching cost of $2.69 per carload.

With respect to costs developed under the individual applications of Rail Form A formula for the Pennsylvania and the L. & N., the following is shown:

	Total out-of-pocket costs	
	Including return on investment	Excluding return on investment
	(In cents per gross ton)	
P.C. & Y. cost based on eastern district Rail Form A (1961); and Pennsylvania cost based on Pennsylvania Rail Form A (1962)	331.4	300.0
L. & N. cost based on L. & N. Rail Form A (1962)	137.5	119.0
Total	468.9	419.0

PROTESTANTS' RAIL COST STUDY

The protestants developed out-of-pocket and fully distributed costs applicable to movement of ingot molds in gondola cars, 112,000 pounds per car, 600 gross tons per shipment, from Neville Island to Steelton. These costs were based on territorial average costs utilizing Rail Carload Cost Scales by Territories for the Year 1961, Statement No. 5-63, prepared by the cost finding section.

The terminal costs were computed from table 3 of the above-mentioned statement and are the average of eastern district and southern region terminal costs for a gondola with a load of 50 tons and, in effect, assigned an eastern district origin cost, at Neville Island, and a southern region termination cost at Steelton.

The protestants used the docket No. 28300 mileage from Neville Island to Cincinnati increased 13 percent for circuity to encompass all the routes to Cincinnati. Eastern district unit costs were applied to the mileage. Further, the rate applies over the L. & N. beyond Cincinnati, and, therefore, the protestants apply southern region unit line-haul costs to the L. & N. mileage from that point to Steelton as shown in supplement 23, I.C.C. A-16622. The costs reflected the movements in way trains and through trains.

The total territorial interchange out-of-pocket costs per loaded car-mile and the constant cost per hundredweight mile were included in the respective line-haul costs. All unit costs per carload were divided by 50 gross tons, the number of gross tons in 112,000 pounds, the minimum weight per car for the $5.11 rate in the tariff. All unit costs shown in per hudred weight were multiplied by 22.4 to obtain unit cost per gross ton of 2,240 pounds.

A cost per gross ton of 5.6448 cents was included for loss and damage claim payments based on that shown for class 579 in appendix A, I.C.C. Statement No. 5-63.

The results of protestants' cost study for the traffic at issue indicate an out-of-pocket cost of 505.8 cents per gross ton and a fully distributed cost of 785.0 cents per gross ton.

Protestants also used respondents' 1961 eastern district and southern region costs to show average total cost (total operating expenses, return and recovery of passenger and less-than-carload deficits) allocated by Rail Form A, schedule G expense groups. The average total costs for the movement of ingot molds from Neville Island to Steelton using the method and operating factors employed by the rail respondents showed—

Movement (1)	Average total cost per gross ton (2)
	Cents
Within eastern district	475.0
Within southern region	212.9
Total	687.9

WATER COSTS

The Mississippi Valley Barge Line, hereinafter called the bargeline, introduced a cost study vased on Barge Form C. It was necessary, as stated by this protestant, to depart from Barge Form C in order to make several adjustments in the terminal areas at Pittsburgh, and in the unloading point at Owensboro, Ky., so as not to overstate costs on the actual movements involved in handling the traffic. The above is particularly true in respect to port service cost, i.e., tug and fleeting costs at origin and destination, which showed an average cost of $9.44 per loaded barge which represented the cost generally of maintaining and operating a fleeting area at Pittsburgh.

DISCUSSION OF THE COST EVIDENCE

We consider first the costs for rail movement.

In their statement No. 5-63 costs, respondents separated from the territorial line-haul costs the interchange switching and intertrain and intratrain switching and included these switchings as they occurred at Duffs Junction and Cincinnati. This procedure is acceptable, as Rail Form A provides for handling switching costs based on either: (1) actual known experience, or (2) on a mileage basis, when actual experience is not known.

Respondents' station clerical costs were not reduced to one-twelfth to reflect the fact that the shipment would be handled in 12-car multiple shipments.

Respondents' use of eastern district average through train weights is based on a 4- or 5-day study sufficiently representative of the proposed operations to be considered reasonably reliable. Similarly, for that portion of the traffic originating on and moving over the P. C. & Y., the respondents' use of the eastern district costs for origin terminal, way train, and interchange produces acceptable costs for that carrier.

Respondents' routing to Steelton of 531 miles was determined by using the actual distance over the P. C. & Y. to Duffs Junction of 7 miles, thence the Pennsylvania to Cincinnati of 304 miles, and then the L. & N. to destination of 220 miles. This routing, involving one actual interchange with no circuity added to the actual miles, is reasonable.

Protestants' rail cost study included 5.6448 cents per gross ton for loss and damage claim payments. This was the average for 1961 of some 20 different items, including iron, steel, and other metallic articles. The respondents in their cost computations did not include any item of

cost for this since the nature of the commodity involved makes unlikely the occurrence of loss and damage. Nor has the consignee experienced any loss or damage. In the circumstances, we agree with this omission.

The protestants made an adjustment in their costs for movements in 600-ton lots, a tariff requirement for the $5.11 rate, by dividing the station clerical expense by 12, the number of 50-gross-ton loaded cars in a 600-gross-ton movement.

Comparison of the respondents' and protestants' rail costs based on statement No. 5-63. (These costs include return on investment and allowance for Federal income taxes.)

	Rate	Out-of-pocket cost	Constant cost	Fully distributed cost
Respondents' exhibits Nos. 9 and 12 (excluding loss and damage)	511	483.5	275.9	759.4
Protestants' exhibit No. 5 (including loss and damage)	511	505.8	279.2	785.0

The respondents' out-of-pocket rail cost study in the eastern district is 14.8 cents more than protestants' out-of-pocket rail cost for the same district. The protestants' out-of-pocket rail cost study in the southern region is 31.4 cents more than the respondents' out-of-pocket rail cost for the same region. Thus, protestants' out-of-pocket rail cost study is 16.6 cents more than respondents'. This latter cost difference does not consider loss and damage costs. Respondents, as stated above, did not include a loss and damage cost in their study, whereas protestants included a cost of 5.6 cents per gross ton. Thus, adding the 5.6 cents to the 16.6 cents provides 22 cents, which

is the total difference between respondents' and protestants' out-of-pocket cost studies.

Protestants in their restatement of respondents' Statement 5-63 costs claim that respondents reduced their out-of-pocket switching costs in the southern region by 32.5 cents per gross ton based solely upon an operation described by an operating witness for respondents. According to protestants, the rail out-of-pocket cost restated to correct for this allegedly unwarranted adjustment in switching costs would be 516 cents per gross ton or 5 cents more than the proposed rate. The 516 cents is obtained by adding the 32.5 cents to respondents' cost of 483.5 cents per gross ton. Indeed, protestants' costs did not reflect any estimate of the reduction in costs (other than station clerical) for handling multiple-car shipments in heavier than average weight trains. However, cost reductions in such instances may be said to be axiomatic. *Asphalt to Iowa, Michigan, Minnesota, and Wisconsin*, 316 I.C.C. 117, 124. See also *Volume rates on Processed Meal—Midwest to Ports*, 322 I.C.C. 456, 485. Rail Form A computations recognize only to a limited degree reductions resulting from multiple-car shipments because applicable Rail Form A costs are based on average switching cost per car resulting from switching cuts of cars of various sizes.

Recent and pertinent cost experience of the past often furnishes an appropriate guide in judging rates for the future. However, if a carrier's costs per 100 pounds or other unit have been high because of low volume of traffic, the use of such costs to determine the reasonableness of a proposed rate, the very purpose of which is to increase a carrier's business, should of necessity be given careful consideration. For example, had the tonnage which a new rate is expected to produce been included in cost calculations the resulting costs would be much lower. Stated in another manner, in judging rates for the future reason-

able prognostications should be given weight. Here, respondents' expert operating witness testified that, in his opinion and on the basis of past experience, a reduction of switching costs would result from the proposed multiple-car movements. As indicated, cost reductions in such situations are axiomatic. Moreover, protestants' cost witness appeared to recognize the foregoing for, when asked if anything, in his opinion, would preclude an actual reduction of the costs resulting from multiple-car movements, he stated:

> No, sir. A study that would be made which would show the time elements for the various types of switching could be made, and it would adjust from the particular point at which the formula had actually developed cost.

In light of the foregoing and since the respondents' witness has not been successfully rebutted, we conclude that the reduction in switching costs would occur. We are convinced that it is more reasonable to recognize the reduction than to reject it.

As to the respondents' individual Rail Form A applications, apart from the aforementioned criticisms as to the territorial costs, protestants appear to find fault here only to the extent that the Pennsylvania did not show the system factors used in preparing its individual carrier costs. However, it appears of record that the respondents' working papers were submitted to the protestants and stood unchallenged at the hearing. In our opinion, the individual cost applications reflect reasonable adjustments appropriate in the circumstances for proposed movements, and stand unrebutted. We so find. While costs cannot be pinpointed here exactly, we conclude that the out-of-pocket costs for the proposed movement reasonably approximate those adduced by respondents by individual application; individual, more specific showings being preferable to territorial averages.

Intermodal cost comparisons

Cost level (1)	Respondents (2)	Protestants (3)	Protestants (4)
	(In cents per gross ton)		
1. Rail out-of-pocket costs:			
1. Territorial costs, statement No. 5-63, adjusted	[1]483.5	[2]505.8	[3]516.0
2. Individual Rail Form A Pennsylvania and L. & N.	[1]468.9		
2. Rail fully distributed costs:			
1. Territorial costs, statement No. 5-63, adjusted	759.4	[2]785.05	(a)759.4
3. Rail average total cost: (or "Full Cost")			(b)617.1
			(c)687.9
			(d)564.3
4. Barge costs: Average total		[4]519.6	
		[5]535.6	

[1] Includes movement of P.C. & Y at eastern district costs for 1961.

[2] This figure was computed and submitted by protestants (Waterways Freight Bureau).

[3] Respondents' territorial out-of-pocket costs (483.5 cents per gross ton) corrected by protestants to adjust for respondents' understatement of switching costs in the southern region; i.e., 32.5 cents (483.5 + 32.5 = 516).

[4] Includes the ancillary charge for transfer and trucking services at destination of 179.0 cents per gross ton plus an operating cost of 340.6 cents per gross ton which included a 4-percent return on investment after Federal income taxes. The latter figure (340.6 cents) is derived by applying return on investment ratios to the respective towboat, barge, and port service costs to arrive at a total cost of $2,119.93 per bargeload. This figure, in turn, is divided by the "load-per-barge factor" of 701.75 net tons (2,000 pounds) resulting in a cost of 3.0209 cents per net ton, to which is added the cargo loss and damage cost of 2.01 cents per ton and provides a cost of 3.0410 cents per net ton. The latter figure is then multiplied by the ratio of 1.12 to expand from cents per net ton to cents per

The above figures for items (a), (b), (c), and (d) represent the result of the protestants' four basic methods for determining "rail full cost." All calculations are based on respondents' territorial costs, statement No. 5-63 adjusted, from which respondents developed an out-of-pocket cost of 483.5 cents per gross ton. The following identifies the four methods:

(a) *Distribution of rail constant costs on basis of service units.*—This method uses the Rail Form A ton and ton-mile distribution of constant costs, which protestant determines to be 275.9 cents and added to respondents' out-of-pocket cost of 483.5 cents to provide the cost of 759.4 cents per gross ton.

(b) *Distribution of rail constant cost on basis of revenue need.*—This method increases the out-of-pocket costs (483.5 cents) by a "carload revenue need ration," determined separately for the eastern district and southern region by dividing the total sum of (1) gross freight revenue—carload, and (2) freight switching revenue (total out-of-pocket expense—carload minus Switching and Terminal Co. out-of-pocket expense and return). The resulting ratios are: eastern district, 1.209; southern region, 1.433. The calculations are:

	Out-of-pocket	Revenue need ratio	Total
	Cents		*Cents*
Eastern district	338.3	1.209	409.0
Southern region	145.2	1.433	208.1
Total	483.5	.....	617.1

gross ton, which produces an operating cost of 340.6 cents per gross ton.

[5] Includes barge costs of 279.93 cents per net ton (or 313.52 cents per gross ton) divided by an operating ratio of 87.9 which provides the figure of 356.68 plus 179 cents per gross ton for ancillary charge resulting in 535.68.

(c) *Average total cost including return on investment and operating deficits.*—Average total cost here consists of total operating expenses, rents, and taxes; 4 percent return on investment (100 percent of road and equipment), after Federal income taxes; and passenger and less-than-carload deficits (exhibit No. 35).

(d) *Average total cost including average revenue need.*—This method consists of rail total operating expenses, rents, and taxes (excluding Federal income taxes) increased by an "average revenue need," the latter revenue need being computed as the ratio of freight operating revenue to freight operating expenses, rents, and taxes (excluding Federal income taxes).

Served December 2, 1965

30300

INTERSTATE COMMERCE COMMISSION

Investigation and Suspension Docket No. 8038

INGOT MOLDS, PA., TO STEELTON, KY.

Decided November 9, 1965

On reconsideration, reduced multiple-car railroad rate on ingot molds, mold stools, and sprue plates from Neville Island and Pittsburgh, Pa., to Steelton, Ky., found unjust and unreasonable, and in contravention of the national transportation policy. Findings in prior report, 323 I.C.C. 758, reversed, schedules ordered canceled, and proceeding discontinued.

Appearances as shown in the prior report and, in addition, *Thomas M. Knebel* and *Bryce Rea, Jr.*, for intervener.

REPORT AND ORDER OF THE COMMISSION ON RECONSIDERATION

BROWN, *Commissioner:*

In the prior report, 323 I.C.C. 758, decided February 2, 1965, division 2 found just, reasonable, and otherwise

lawful the reduced railroad rate [1] of $5.11 on ingot molds, mold stools, and sprue plates, hereinafter called ingot molds, from Neville Island and Pittsburgh, Pa., to Steelton, Ky. Upon petition of the respondent railroads [2] and the protestant bargelines,[3] the proceeding was reopened by the Commission for reconsideration on the present record. The National Motor Freight Traffic Association, Inc., was permitted to intervene and file a reply to the respondents' petition.

These schedules became effective March 19, 1965. For convenience, however, the rate at issue will be called the proposed rate. The facts are adequately set forth in the prior report, and will be restated only where helpful for a clear understanding of the issues.

Since 1953, the movement of this traffic has been principally by barge-truck. The overall charge of $5.11 for movement by barge-truck consists of a barge rate of $3.32, minimum 600 gross tons, a barge-to-truck transfer charge of 95 cents at Owensboro, Ky., and a for-hire truck charge of 84 cents beyond. In 1953, the barge rate was $2.84, minimum 500 gross tons. That rate was subsequently increased to the present level and minimum, which were attained in November 1960.

Prior to the publication of the proposed rate, rail shipments were limited to instances of special orders for ingot molds required by the receiver's production schedules. According to consignee testimony, railroads cannot effectively participate in the movement, unless their rate

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[1] Rates, costs, charges, and differences therein are stated per gross ton, unless otherwise indicated.

[2] The Pennsylvania Railroad Company (the Pennsylvania) and the Louisville and Nashville Railroad Company (the L. & N.).

[3] Mississippi Valley Barge Line Company (Mississippi), The Ohio River Company (Ohio), and Union Barge Line Corporation (Union).

would not exceed the total cost to the consignee of barge-truck service. As noted above, that cost is $5.11. The present rail rate is $11.86,[4] subject to a carload minimum of 100,000 pounds. The proposal applies to a minimum of 600 gross tons in single shipments, minimum 112,000 pounds per car, on one bill of lading from one consignor at one origin to one consignee at one destination, tendered in one day.

In approving the rate, division 2, noted that—

> * * * protestant bargelines have chosen for some time to forego the revenues of a rate set at a level which would return fully distributed costs. They have done so voluntarily and, considering the rail rate levels and the fact that the traffic has moved almost exclusively by barge since 1953, without being subject to any competitive compulsion insofar as respondents are concerned. * * * From all that appears of record, protestants' choice in setting their rate at the level respondents now seek merely to meet was also reached voluntarily. Such action affords no basis for assuming that the action of respondents in meeting but not undercutting protestants' rate destroys an inherent cost advantage. Indeed, we think it plain that protestants, being in a position of their own free choosing, cannot successfully object to a rate which, we find, will return revenues reasonably in excess of out-of-pocket costs * * *. [323 I.C.C. 758, 763.]

Division 2 then concluded that the rate was compensatory and just and reasonable and not a destructive competitive practice in derogation of the national transportation policy.

The respondents, in their petition for reconsideration, request that division 2's report be modified. They urge

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[4] Conversion to a gross-ton basis of the rate of $10.59 published per net ton, effective in February 1963.

the elimination of a policy statement to the effect that fully distributed costs are adhered to by the Commission in determining the low-cost mode. It is respondents' position that only out-of-pocket (incremental) costs of the proponent carrier should be considered, and that a rate which exceeds such costs is lawful. In their view no reliable intermodal cost comparison can be made and none should be attempted. The protestants, however, argue that intermodal cost comparisons should be made and that those compared should be on the full-cost level.

In their petition, the protestant bargelines argue that the report of division 2 is contrary to the legislative history of section 15a(3) of the Interstate Commerce Act, and cannot be reconciled with any reasonable theory of destructive competition, as reflected in the national transportation policy.

No serious dispute is raised on petition as to the analysis of the cost evidence in the prior report. We adopt such statements therein as our own. The proposed rate exceeds the rail respondents' out-of-pocket cost of 468.9 cents by 42.1 cents. The rail fully distributed cost is 759.4 cents, and the comparable full cost for barge-truck service is 519.6 [5] cents. The proposed rate, which is on parity with the total charges for barge-truck service, is below the rail fully distributed cost by 248.4 cents and below the barge-truck full cost by 8.6 cents.

The protestants contend that the costs of Mississippi are typical of the costs of all barge protestants herein since the cost factors for the different carrier lines are very similar. Mississippi handled 10 of the 19 shipments in the period 1961-63, and we accept the cost figures from its data as representative for our purposes herein.

[5] Includes barge full costs of 340.6 cents, plus the barge-to-truck transfer charge of 95 cents and the for-hire truck charge of 84 cents.

The costs of providing additional services attending the movement of traffic by barge are not shown on this record. Division 2, relying on the Commission's findings in *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 784, added the aggregate of such charges to the barge costs in computing the full cost of barge-truck service herein. Under the circumstances here present, we accept the division's computation of barge-truck costs.

Division 2 further concluded that other service considerations of the competing modes were not shown of record to be controlling. We agree that in this context neither mode possesses any material inherent service advantage.

DISCUSSION AND CONCLUSIONS

Simply stated, the railroads are here proposing a rate of $5.11, that meets the charges, $5.11, to the shipper who utilizes barge-truck. The rail rate is below its fully distributed costs of $7.59. The barge-truck charges are below its fully distributed costs of 519.6 cents but, as noted, the barge-truck fully distributed costs are considerably lower than those of the railroads. Under equal charges, rail respondents virtually concede that all of the traffic would move by rail.

Section 15a(3) of the act provides that—

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of

> the national transportation policy declared in this Act.

As pertinent here, the national transportation policy provides for—

> * * * fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each * * * to promote * * * and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without * * * unfair or destructive competitive practices; * * *.

In *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 762 (1963), the Supreme Court observed that—

> The primary reason for the reference to the National Transportation Policy in § 15a(3) was to confirm the Commission's power to protect the inherent advantages of all carriers from destructive competition.

Cost is such an advantage. *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra*, 759.

The importance of this case rests upon the resolve of a fundamental proposition: the criteria for determining how the low-cost carrier's inherent advantages should be measured and protected. Such a determination comprehends a comparison of the cost advantages of two competing modes of carriage. It could not be determined, *in vacuo*, by viewing the operations of a single carrier or mode, as urged by the respondents.

In *Grain in Multiple-Car Shipments—River Crossings to So.*, 325 I.C.C. 752, 772, the Commission recognized that—

> Although the fully distributed cost standard requires an arbitrary assignment of constant costs to

particular traffic, that standard has generally been employed in measuring inherent cost advantages in intermodal competitive rate controversies.

In the prior report, division 2, concluded that—

> * * * whenever [regulated] competitive carriers of different modes assert cost advantages inherent to their respective modes, * * * [the Commission has] recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is reasonably practicable to apportion. [323 I.C.C. 758, 762.]

We agree. The rail respondents, however, argue against the use of such standard. On reply to protestants' petition for reconsideration respondents urge that—

> * * * a rate is "profitable" if it produces revenues in excess of the incremental [out-of-pocket] costs of providing the service. And a rate achieves maximum profits when the revenues per unit above the incremental cost of producing the unit, multiplied by the units sold reaches the optimum. This in turn depends upon the demand for the service at varying price levels. The optimum price being a function of the varying demand at different price levels, it follows that it may be relatively close to the incremental cost level or considerably above it. But if the price is optimum, regardless of its relationship to a fully distributed cost level determined by a statistical allocation of the constant expenses, it will make the maximum contribution to the pricer's net. * * * the optimum price oriented to the incremental cost as the floor is "fully compensatory" for no other price can produce as great a contribution. Thus, a fully compensatory rate is one which produces the maximum contribution; and for it to be achieved, the only relevant cost level is incremental cost. Within a multiservice industry, it will only be a coincidence, something equivalent to receiving 13 cards of one suit in a bridge hand, where the fully

compensatory rate—if this means the rate producing the maximum profit—happens to equal a statistically determined "fully distributed" costs.

* * * So far as the volume movement of ingot molds is concerned, the single car rate of $11.86 per ton, which existed prior to the reduced rate and still is available, has produced no traffic. While it exceeds the fully distributed cost level, it produces no net with respect to the volume movement of this traffic. Viewed from the railroads' standpoint, it is a "non-compensatory" rate since it generates no profits. By contrast, the reduced multiple car rate of $5.11 per ton will generate a considerable movement of the volume tonnage. If the shipper is to be believed, and the railroads believe him—and the Commission has no reason for doing otherwise—the rail rate must be at this level or lower if the railroads are to haul any of the volume movement. This reduced rate, which amply covers the incremental costs but falls short of the artificial fully distributed level, is therefore not only a profitable rate, but actually the most profitable rate the railroads can charge on this traffic. It is also, therefore, a "fully-compensatory" rate since no other rate would produce as much net.

We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, does not necessarily mean that the

carrier is the more efficient of the two. Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve.

Moreover, regulation could neither be fair nor impartial if we did not recognize the fact that the carriers before us do not compete for every type of traffic. It is quite obvious, for example, that the traffic here involved is of far more consequence to the barges than to the railroads. Analysis of 1962 systemwide revenues for the Waterways Freight Bureau's members indicates that iron and steel products, which includes ingot molds, is the third most important commodity group transported in barge service, accounting for 10.81 percent of their total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of the total barge revenue. In fact, the railroads readily concede this point. In short, an inherent cost advantage under the national transportation policy reasonably could not embrace a concept that would impair the ability of a carrier not only to compete but to exist.

In the prior report division 2 concluded that—

> It may readily be inferred that protestants would have raised their rate to a higher level * * * had they themselves deemed it appropriate to protect their inherent advantage. * * * protestants' cost advantage is such that they are in a position to continue to compete effectively and still charge a [reasonable] rate * * *. [323 I.C.C. 758, 764.]

We disagree. To have any validity the concept of an inherent cost advantage must have a definitive meaning. It could not, therefore, be framed within such a relative context, as suggested in the prior report. Either one mode or the other possesses an inherent cost advantage, and

that advantage is not subject to the sport of chance. That is to say, such an advantage cannot be lost merely by the creation, accidental or otherwise, of a rate below a fully distributed cost level. It appears so obvious here, for example, that the barge protestants were not aware of the precise cost level when their present rate was set.

In *Pig Iron, Buffalo, N. Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 131, 129-130, the Commission, division 2, concluded that—

> * * * the principal purpose of the reference in section 15a(3) to the national transportation policy was to prevent a carrier from setting a rate which would impair or destroy the inherent advantages of a competing carrier, for example, by setting a rate, below its own fully distributed costs, which would force a competitor with a cost advantage on particular transportation to establish an unprofitable rate in order to attract traffic. It is readily apparent that if the reduced rates are approved from the five origins where protestant * * * [barge lines are] the low-cost carrier, any reductions in the water carrier rates necessitated thereby would necessarily be brought to a level below fully distributed cost. Therefore, the reduced rail rates result in a destructive competitive practice in contravention of the national transportation policy since the rates are substantially below the respondents' fully distributed costs and will force the protestant, which has a cost advantage, to establish unprofitable rates in order to remain competitive. This, in turn, would impair or destroy the protestant's inherent cost advantage.

As pointed out in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, *supra*, 757,

> There can be no doubt that the purpose of this provision [§ 15a(3)] was to permit the railroads to respond to competition by asserting whatever inherent advantages of cost and service they possessed.

In circumstances such as here presented where both the proponent carrier and the competing carrier are regulated, the Commission consistently has utilized the fully distributed cost standard to determine which mode of carriage possesses an inherent cost advantage. *Electric Cable & Wire, Worcester, Mass., to Houston, Tex.*, 319 I.C.C. 390; *Plastics from Texas to the East*, 319 I.C.C. 379; *Frozen Juice and Fruit from Florida to the North*, 319 I.C.C. 577; and *Candy and Confectionery from N. J., N. Y., & Pa. to Tex.*, 321 I.C.C. 154. Under that standard the rail respondents here do not possess an inherent cost advantage.

The propriety of using the fully distributed cost standard and questions respecting the proper construction of costs for the various modes are among the issues in the broad rulemaking proceeding of docket No. 34013, Rules Governing the Assembling and Presenting of Cost Evidence. A radical departure from the fully distributed cost norm as urged by the respondents would not be justified on the limited record here before us, particularly when such issues are to be determined on a comprehensive record in docket No. 34013.

The Supreme Court emphasized in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra*, that—

> The principal reason for this reference [in § 15a(3) to the national transportation policy], as the hearings show, was to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes. And the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed

cost and thus perhaps to go out of business. [372 U.S., 744, 758.]

On a fully distributed basis, the low-cost mode of transport is barge-truck. We do not agree with division 2's conclusion that the barge "cost advantage is such that * * * [those carriers] are in a position to continue to compete effectively and still charge a rate reasonably in excess of out-of-pocket costs, * * * even if they were to reduce their rates." 323 I.C.C. 758, 764.

Nothing in that report suggests that such a reduction in the rate of the barge-motor lines cannot be matched by successive reductions in the railroad rates. The railroad out-of-pocket costs are lower than the barge-motor lines' variable costs. Therefore, the railroads can wage the rate battle as long as or longer than the barge-motor lines. The rationale of the division's report would permit no ground upon which the Commission would be able to intercede to halt such a devastating rate war. While this may give full rein to the "play of competition," 323 I.C.C. 758, 764, it is difficult, if not impossible, to comprehend how it would accord recognition and preservation of inherent advantages as contemplated by the national transportation policy.

In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. Cf. *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567, 575-579 (1947); *Dixie Carriers, Inc.* v. *United States*, 351 U.S. 56 (1956).

Upon reconsideration, we find the reduced multiple-car rate, minimum 600 gross tons per shipment, on ingot

molds from Neville Island and Pittsburgh, Pa., to Steelton, Ky., unjust and unreasonable, and in contravention of the national transportation policy. The findings in the prior report are reversed.

VICE CHAIRMAN BUSH, dissenting:

Carrier initiated ratemaking innovations, compatible with the requirements of law and practical factors such as numerous and varied present day operational and technological advancements by those subject to rate regulation by us, do not warrant disapproval by administrative fiat. The finding of unlawfulness herein rests, in my view of the record, solely upon an adverse concept, which is contrary to the provisions of the Interstate Commerce Act, as well as Commission and judicial precedent of long standing.

Conspicuous by its *absence* is an important element of proof of the lawfulness of the proposal, particularly in an intermodal rate adjustment, namely: the unrebutted evidence of a competitive necessity, which has been affirmatively shown of record by respondents. Under the facts here presented, I can find no justification for ignoring this essential ratemaking factor of longstanding precedent in making such a determination herein.

Conspicuous by its *presence*, however, is a purely speculative and unprecedented theory wholly without evidentiary support nor cogent supporting reasons, relative to the manner in which cost concepts are applied, allegedly to justify disapproval of the proposal. The determination of the compensatory nature of any rate proposal and of the necessity that it comport with the rule of ratemaking set forth in section 15a of the act, as amended, requires a comparison of like with like factors, rather than the comparison of data incompatible with each other. Admittedly, the involved rail and barge-truck rates are be-

low the fully distributed cost level for the respective modes as is determined herein. Appropriate consideration is then given to a comparison of the proposed rail rate with those costs incurred by the *rail proponents* in accord with our longstanding practice as recognized by all modes of regulated transport. Then, in circumvention of reality and by adoption of a concept of first impression, the determination rests upon the foregoing cost comparison with the barge-truck costs to the *shipper*, rather than costs of the barge-truck movement to such carriers, to prove they possess the inherent advantage of being the low-cost mode of transport. A realistic evaluation indicative of the falsity of such a costing concept for carrier transportation is self evident, for what it costs the shipper to move its traffic are the *rates* of the carrier plus any other additional shipper incurred expense; yet costs to the carrier, in the absence of unusual circumstances not here present, do not constitute the rate paid by the shipper. Were it otherwise, the inherent carrier cost advantage would not be susceptible of reasonable precision but would be a relative concept, determinable solely by presentation of expenses of unregulated noncarriers. Such is not contemplated by any provision of the act nor judicial requirement.

Finally, although it is incumbent upon us to recognize and preserve the inherent advantages, of which cost is only one, possessed by any rate-regulated mode as contemplated by the national transportation policy, it is not within our province to remain oblivious to the bargeline protestants' evidence of their inherent disadvantages due to *inferior service*. Such an admission against interest militates against the finding herein that neither mode possesses any material inherent service advantage, and adequately supports the conclusion that such is inherent in rail service.

Upon consideration of the record in its entirety, I would therefore find the proposal just, reasonable, and otherwise lawful and discontinue the proceeding.

COMMISSIONER FREAS, dissenting:

In *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra*, called *New Haven*, the Supreme Court indicated that "hard competition" was contemplated by section 15a(3), and that we were no longer to be "a giant handicapper." Yet, the majority now holds that a carrier with an inherent cost advantage must, nevertheless, be protected against another carrier which has not been a competitive factor heretofore and which seeks only to meet the going rate on a compensatory basis. If the instant holding reflects any reasoned consideration of "hard competition," it will surely come as a surprise to the successful proponents of both section 15a(3) and *New Haven*.

Moreover, the protection[6] would utilize fully distributed costs to set the rate level. It is one thing to utilize the fully distributed formula to determine the existence of an "inherent advantage" as between unlikes; it is quite another to use it as a pricing floor. In light of the arbitrary aspects[7] of fully distributed costs, I find it hard to square the majority's cavalier acceptance of those costs as a pricing floor with more relaxed and, to an extent, incremental, standards of other formulas. See, e.g., *Animal Feed from Kansas City, Mo., to Chicago*, 325 I.C.C. 147, *Carbon Blacks from the Southwest to Ind., Ohio & Mo.*, 325 I.C.C. 138, and *Aluminum Extrusions from Miami to Chicago*, 325 I.C.C. 188, and the approval given

[6] "Insulation" would be a more apt term.

[7] Including the failure to give effect to public costs. See *Grain in Multiple-Car Shipments—River Crossings to So.*, 318 I.C.C. 641, 682-683, 321 I.C.C. 582, 618-621 (dissenting opinion).

therein to significant departures from past costing practices, the pendency of docket No. 34013 notwithstanding. In essence, the majority's approach is nothing more than a return to the arbitrary percentage differentials struck down in *New Haven*. It is worthy to note, however, that as to a comparable proposal on a substantially similar movement the proponents thereof ultimately prevailed in court. *Pig Iron from Neville Island, Pa., to Louisville, Ky.*, 313 I.C.C. 771 (1961), reversed in *Pennsylvania R. Co.* v. *United States*, 202 F. Supp. 584 (E.D. Pa. 1962).

As I see it, the majority has come full circle to the pre-section 15a(3) days before 1958, and is once again indulging in the arbitrary allocating of traffic among the various modes. It has done so by equating, in effect, fully distributed costs with a profitable rate. However, the protestants, for whatever reason and certainly not because of rail competition, do not realize such costs. In the circumstances, it must be presumed that ingot mold traffic has returned satisfactory profits. Therefore, it is appropriate to ask what, in actual effect, is being protected since as a fact of competitive economic life protestants' advantage has been a mere cipher. Nor can I indulge in the majority's venture into speculation as to the danger to protestants' survival due to the possible loss of this specific traffic. In actuality, it forms a very small segment of protestants' tonnage and revenue. The majority's logic dictates, if the water carriers' interests are to be protected, a raising of their rate and indeed those of all carriers generally to the fully distributed level. Yet, such an approach has never been taken, nor is it readily apparent why this particular area of rate-making should necessarily be singled out for the restrictive embrace of price fixing at a high level. The majority by its own admission refuses to impose it elsewhere, presumably even where unregulated water carriage is involved.

It is indeed unfortunate that the majority has chosen to limit its ratemaking considerations to the inflexible framing of the issues by the parties.[8] One can understand the narrow position taken by the parties for, if fully distributed costs are to set the rate level, the water carriers need rarely fear rail competition. Conversely, if incremental or out-of-pocket costs both measure inherent advantage and set the rate level, relatively few rail reductions would merit disapproval. But ratemaking is not, and cannot be, limited by application of an inflexible mechanical formula. Once it is determined which mode has the low-cost advantage, the effect of a proposed rate must be measured in that light. To limit a proposed reduction in rate to the fully distributed level of another mode, regardless of the level of the other mode's rate or of other transportation circumstances, is patently anticompetitive. It must be determined whether there is room for reasonable competition. The writer so testified on behalf of the Commission in hearings which ultimately culminated in the passage of section 15a(3). See e.g., Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce on Problems of the Railroad, 85th Cong., 2d sess., pt. 3, at 1884 *passim* (1958). As I understand matters, the Congress nevertheless determined to avoid what is considered to be past inconsistencies by writing a specific provision eliminating some of the supposed previously existing paternalism imposed under section 15a (2). Such action was taken despite the existing requirement in section 15a(2) that consideration be given to the need, in the public interest, of adequate and efficient rail

[8] Such an approach does not, in my opinion, reflect the full consideration of the choice which must be made between different remedies with different consequences to the carriers and the public. *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 167-168. See also *Gilbertville Trucking Co.* v. *United States*, 371 U.S. 115, 130-131; *New Haven*, 372 U.S. 744, 763; *Atchison, T. & S. F. Ry. Co.* v. *United States*, 225 F. Supp. 584, 606-607 (D. Colo. 1964).

service at the lowest cost consistent with the furnishing of such service.

Section 15a(3) directs us to consider the facts and circumstances attending the movement of the traffic. If there is room for reasonable competition, then a rate may be approved since the inherent advantage of the low cost of the competing mode will still be preserved. That is, the low-cost mode will still be able to compete. *Accord, New Haven*, 372 U.S. 744, 761, n. 14. Here, the proposed rate meets, not undercuts, the water-truck rate and reasonably exceeds out-of-pocket costs in the circumstances presented. Yet, the water-truck rate can still be competitively reduced if such action proves necessary, despite shipper testimony to the contrary, to participate in the traffic.[9] Indeed, such a reduction, even a small one, would in all likelihood, recapture the traffic since any subsequent rail reduction would probably be noncompensatory. Such a conclusion is evident from a comparison on a hundredweight basis of the rail costs accepted as valid with the rail rate. The water-truck movement, on the other hand, would have lower variable costs if the 90-percent variable figure recently referred to in *Grain in Mutiple-Car Shipments—River Crossings to So.*, 325 I.C.C. 752, 774, n. 11 (1965), for example, is controlling. The statement in the report that the railroad out-of-pocket costs are lower than the barge-motor variable costs is presumably the result of accepting uncritically a variability figure approximating 100 percent for protestants; a figure not conceded by protestants and rightly so since it assumes that equipment is being put to full use all of the time, a millennium few carriers have reached. Apart from the foregoing weakness in the majority's approach,

[9] It should be observed that the conclusion that a reduction by protestants would be necessary to participate plainly implies a service advantage on the part of respondents at equal rates; an advantage which should not go unrecognized.

even a 90-percent figure should no doubt be lower if it is assumed, as it can be, that the truck costs erroneously equated [10] by the majority with the truck charge are, in fact, less than the latter.

Preserving an inherent advantage does not, in my opinion, mean rate stratification. *New Haven*, when read in its proper context,[11] and the legislative history stand for no such principle. The division report reached the correct result on both realistic economic and legal grounds, and, in so doing, properly accommodated the different views of the parties. I would affirm the findings in the report.

I can appreciate a quest for certainty in decision-making but there are no absolutes in the pragmatic, competitive world of ratemaking. By refusing to recognize legitimate commercial objectives, I believe the majority's action invites both reversal in court and legislative action. I am unwilling to assume that the underlying congressional efforts were for nought.

COMMISSIONER TIERNEY, dissenting:

I would affirm the findings in the prior report that the proposed rate is just and reasonable, and not destructively competitive.

The rate maintained by protestant bargelines and at which they transported the traffic over a period of years was not set at that particular level for any competitive reason. Under the circumstances we must assume that such rate was at a profitable level. Therefore, the fully distributed cost level cannot, in this situation, be said to

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[10] See *Eastern Central Motor Carriers Assn. v. United States*, 239 F. Supp. 591 (D.D.C. 1965).

[11] Similarly, a proper reading of the *Pig Iron* case, 321 I.C.C. 121, cited by the majority, will disclose that the proponents there sought to undercut substantially, not merely to meet, the low-cost mode. I submit that the distinction is material.

represent the lowest profitable level since the water carriers were apparently conducting profitable operations (in the absence of competitive rates) at a rate below their full cost of service. Cf. *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 759-761 (1963).

In a proceeding of this nature, the proponent of the rate must show (1) its costs, (2) that the proposal is just and reasonable from the standpoint of its own revenue requirements, and (3) that the proposal is not destructively competitive; and the party asserting that it has the inherent cost advantage must rebut the foregoing by showing *(a)* its costs, *(b)* the lowest level at which it may conduct competitive operations and continue to operate at a profit, and *(c)* the asserted differential, if one is necessary, for participation in the involved traffic. Here, the rails, in my opinion, have met their *prima facie* burden with evidence that the rate is just and reasonable and not destructively competitive; and the water carriers have not sufficiently rebutted such evidence. Accordingly, I would allow the public to receive the benefit of hard competition in the situation before us.

While the water carriers are the low-cost mode, there is no way to determine on the evidence of this record the lowest level at which they can effectively compete and continue to operate at a profit. Although the shipper testified of his intent to divide the traffic between the two modes, the respondents and protestants are in virtual agreement that at equal charges the shipper will tender all of the traffic to the rails. Under these circumstances, protestants were remiss in not furnishing us with the above-specified evidence.

The majority's action herein, utilizing arbitrarily the fully distributed cost level of the low-cost mode as a floor below which the high-cost mode cannot go in establishing

a competitive rate on a compensatory basis, in my opinion, is contrary to the legislative history of section 15a (3).

It is ordered, That the respondents herein be, and they are hereby, notified and required to cancel the schedules described in the order entered by the Commission's Board of Suspension on November 27, 1963, on or before January 3, 1966, upon not less than one day's notice to this Commission and to the general public by filing and posting in the manner prescribed under section 6 of the Interstate Commerce Act, and that this proceeding be, and it is hereby, discontinued.

By the Commission.

H. NEIL GARSON
Secretary

(SEAL)

Exhibit No. 37

STATEMENT OF WILLIAM J. BAUMOL

My name is William J. Baumol. I was awarded a degree of Bachelor of Social Science at the College of the City of New York in 1942. I received my Ph.D. in Economics from the University of London in 1949. I am the author of the following books: *Economic Dynamics,* MacMillan, New York, 1951, 2nd edition, 1959; *Welfare Economics and the Theory of the State,* Howard University Press, 1952; *Economic Processes and Policies,* L. V. Chandler co-author, Harper, New York, 1954; *Business Behavior Value and Growth,* Macmillan, New York, 1959; *Economic Theory and Operations Analysis,* Prentice-Hall, Englewood Cliffs, New Jersey, 1961; and co-editor with Klaus Knorr of *What Price Economic Growth?,* Prentice-Hall, Englewood Cliffs, New Jersey, 1961.

I am also the author of numerous articles appearing in such journals as *American Economic Review, Harvard Business Review, Management Science, Operations Research Quarterly Journal of Economics, Journal of Political Economy, Review of Economics and Statistics, Economic Journal, Economica, Econometrica, The Review of Economic Studies and Kyklos,* and am currently an American editor of the *Review of Economic Studies.* One of the articles which I co-authored is *The Role of Costs in the Minimum Pricing of Railroad Services* which appeared in the October 1962 edition of the Journal of Business of the University of Chicago. A copy of this article is attached to my statement.

I taught at the London School of Economics from 1947 to 1949 and since then have been teaching at Princeton University where I am now full professor in the Department of Economics. I have also done some teaching at the University of California at Berkeley and Columbia University. I am a Fellow and Member of the Council of the Econometric Society and have been a candidate for the Presidency.

of the Institute of Management Science (TIMS) in which I currently hold several committee chairmanships. I was at one point president of the central New Jersey chapter of the American Statistical Association.

I have done a considerable amount of industrial consulting both independently and through the consulting firms of Alderson Associates in Philadelphia and Mathematica in Princeton, New Jersey. Among the firms for which I have consulted are The Monsanto Chemical Company, The Anheuser-Busch Brewing Company, Carpenter Steel Company, the Portland Gas Company, the Harvey Leather Company, Meade Johnson and Company, the General Foods Corporation, Morgan, Stanley and Company, and I am currently on an advisory committee to the President of the Prudential Insurance Company. In addition, I have consulted for numerous governmental agencies, including the United States Department of Agriculture and the United States Navy for whom I have worked on problems of transportation. Though my work has primarily centered around liberal arts institutions, I have given guest lectures at a variety of business schools, have been consulted on problems pertaining to their curricula, and have addressed numerous annual meetings of the American Marketing Association and various special marketing groups.

I am co-author of the basic article on economics to appear in the next edition of the Encyclopedia Britannica and am currently in charge of the graduate program in Economics at Princeton University. My books are used in a considerable number of institutions throughout the world and several of them have been translated or are in course of translation.

My industrial experience includes a variety of pricing problems pertaining to different types of industrial operation. For example, my work for the Portland Gas Company and for the Anheuser-Busch Brewing Company was primarily concerned with pricing problems. Transportation problems play a role in several of my writings and appear expli-

citly in my book, *Business Behavior, Value and Growth*, as well as in a paper delivered before the annual meetings of the American Marketing Association in New York City in December of 1961. A very considerable portion of my writings are most explicitly concerned with problems of pricing within the business firm.

Section 1. Introduction

There is no question that cost data are pertinent to railroad pricing and to many regulatory decisions in this area. The type of cost figure which is appropriate for use in this decision process is clear to economists, but it seems to have been beclouded by arguments presented to the Interstate Commerce Commission on behalf of various parties. This exhibit undertakes to explain the conclusions of economic analysis on this matter.

It is important to recognize that the discussion which follows does not represent the views of one or a few economists or even of a narrow school of economic analysts; rather it can be stated without hesitation that it would receive the support of the vast majority of reputable members of the profession. Once they are fully understood, the concepts described can be considered to consist of results fully supported by formal logic so that the fundamentals of the analysis are largely beyond dispute.

This analysis leads to three fundamental conclusions which should be summarized at the outset:

1. That the type of cost datum which is most pertinent and validly employed in the setting of price floors (Minimum rates) is incremental or marginal cost. Artificial concepts, such as fully distributed cost, are irrelevant for the purpose and the use of such measures can impose unjustifiable burdens on the carriers and lead to inefficient utilization of transport facilities.

2. In determining any price floors for the services of a particular carrier, only the incremental costs incurred directly or indirectly by *that* carrier in providing that par-

ticular service are always pertinent. Cost data pertaining to any other carrier or any other services of the carrier in question are irrelevant and lead to decisions which are harmful to the economy as a whole as well as to the individual carrier.

3. Regulation of minimum rates should address itself to the effective prevention of destructive competitive practices. Once having set up an effective machinery for this purpose, it should be the objective of the Interstate Commerce Commission and other regulatory agencies to provide maximal scope for unhampered freedom of decision on the part of the carriers which constitute our transportation industry. For efficiency of the free enterprise system requires that, within appropriate limits, carriers be given the opportunity to exercise their initiative in settling their rates in accord with the profit motive.

The remainder of this statement is devoted to an explanation of the concepts which have just been mentioned and to indicate the rationale which underlies the tenets that have just been enunciated.

Section 2. Incremental Costs - The Cost Datum for Decision Making.

There is a basic parallel in the structure of the objectives which private firms and society as a whole try to achieve through their economic activities. In both cases, their goal is to obtain as large a yield as possible from the limited resources which are available to them, that is, to utilize their economic resources as effectively as possible. But in order to maximize profits, or to maximize the amount of physical transportation achieved, or to maximize anything else, it is necessary in the course of the decision process either explicitly or implicitly to make use of the fundamental incremental cost concept. This assertion is simply a restatement of a fundamental principle familiar to mathematicians and all those, like engineers, who apply mathematics to decision making. In particular, a carrier which is undertaking to maximize the contribution made by its operations to its

profits and the defrayment of its overheads must, in the course of its pricing decisions, utilize data reflecting, as accurately as possible, its incremental or marginal costs; and it must use these rather than some artificial composite figure such as fully-distributed costs. Insofar as the latter is used as a substitute for the former, pricing calculations are likely to involve a loss in profits to the company and a reduction in the efficiency of the utilization of society's transportation resources.

Though the concept may at first appear to be relatively complex and abstract, the notion of incremental costs is really rather simple, and the reason why it is pertinent is not difficult to follow.

It may be noted that the incremental cost concept is not dissimilar in principle from what the Cost Finding Section of the Interstate Commerce Commission refers to as out-of-pocket costs. Thus, in Statement No. 7-63, "Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs" (November 1963), the Cost Finding Section states:

> "These 'out-of-pocket' costs are sometimes referred to as added traffic costs, marginal costs, direct costs, assignable costs, separable costs, traced costs, or prime costs. Whatever the term used, the figures have reality in rate making only to the extent that they reflect the added costs which were incurred because the traffic in question was handled, or the costs which could have been avoided if the traffic were not handled." (p. 3)

Let us examine precisely what is meant by *incremental costs* and indicate how they are measured. The incremental costs of any output or service is defined as the addition to total cost which is incurred by any unit of that output or service (where this cost is measured per unit increase of that output). For example, if a railroad could save $120 by means of a 1000 ton-mile reduction in the amount of some product it carries, it is clear that the 1000 ton-miles carried was responsible for an increment in its total cost.

amounting to $120. This means that the incremental cost is $120 divided by 1000 or 12 cents per ton mile. Of course, this figure applies equally to *any* 1000 units of this particular traffic having the same transportation characteristics. Since the railroad can reduce its outlays by $120 through the elimination of *any* 1000 ton miles of this traffic, the same incremental cost figure and, hence, presumably the same price pertains to any such portion of that traffic.

It is important to notice that this concept concerns itself in principle with current and potential costs of operation, outlays over which the actions of management can have some influence. It wastes no time on sunk cost figures drawn from ancient history which are beyond anyone's control, but inquires instead how much must be spent in order to make it possible to continue the provision of that service so long as a profitable market remains available.

How then does the incremental cost concept enter the decision process? As already indicated, it is a necessary tool of any maximization calculation. Maximization of profit, for example, requires the decision maker to take advantage of every opportunity to add to the net returns of the company. It costs a railroad money if it neglects an opportunity to establish a rate reduction which will generate new traffic of a type not presently being handled providing revenues in excess of the added costs incurred by supplying that output. Similarly, it costs a railroad money if it fails to establish a rate reduction which will generate additional traffic of a type being presently handled, if the total amount to be realized above the incremental costs of transporting the larger volume will exceed that realized from the smaller volume being presently handled. The outputs and rates of a railroad can only be optimal from its own point of view if no change in either of these variables will *add* more to revenue than it does to costs. That is, to test whether we have achieved a maximum, we must compare *incremental costs* with incremental revenue. It is impossible to achieve a maximum without taking advantage of every possibility

which offers an incremental revenue greater than the corresponding incremental cost. Exactly the same principle applies to decisions designed to maximize the welfare of society or to any other maximization calculation.

If any floor on rates, other than that provided by incremental cost is artificially imposed by regulatory decisions, both the public and the business firms involved must necessarily be harmed. The public must suffer because of the lost opportunities to obtain goods and services whose value exceeds the added costs incurred. The participating carriers must lose because they are forced to forego opportunities to supply services which could have provided a contribution to profit and overhead, that is, whose incremental revenues would be greater than their incremental costs.

Section 3. **Incremental Cost as an Appropriate Floor for Railroad Rates.**

It is surely socially desirable in itself to have service provided to the public at prices as low as is possible. This is inherent in the basic logic of the competitive process and the reason why it has received such wide approbation. In general therefore, it would seem appropriate to encourage rate reduction in transportation and, from the point of view of society, the burden of proof would appear to rest on those who would seek to prevent it. Indeed, there appears to be only one good reason justifying the imposition of a floor below which rates are not permitted to fall. This purpose is, of course, to prevent any carrier from pricing at a level so low that its operations would not be viable and where the sole purpose of such a noncompensatory rate is to drive out competitors. There is much to be said for prevention of this sort of destructive competition, and data reporting the costs of a carrier can be of some help in its prevention.

In the determination of any minimum rate to be used for such purposes, incremental costs are of unique significance. First of all, any carrier which charges a rate that is below incremental cost is necessarily making a sacrifice of its profit and, as it were, providing a loss leader to the users of

its services. Any continuing operation of this variety must constitute a cumulative drain upon the carrier's resources. Thus, any such price arrangement may be taken to constitute evidence of predatory pricing.

On the other hand, where a particular rate exceeds the corresponding incremental costs, it cannot be legitimately argued, on the basis of cost considerations, that it is designed as an instrument of destructive competition. Carriers will frequently find it profitable and natural to supply services at a rate which yields only a small margin above incremental costs. Since some addition to profit is always better than none, a railroad cannot, in self interest, refuse to undertake any services for which it will obtain the requisite purchasers at a rate which is slightly above incremental cost, and the failure to supply such a service can only be interpreted as a deliberate sacrifice of profits. Thus, contrary to what is sometimes alleged, freedom to charge prices based on incremental costs can *aid* firms to recover their overhead costs. If a company cannot recover its costs when its prices are set so as to maximize its profits, no substitute pricing gimmick can enable it to cover these costs.

It follows therefore that if costs were to be used as a criterion for rate regulation, only incremental costs can provide an appropriate floor for rates. Any floor higher than this must inevitably force carriers to lose potential profits and potential business.

Moreover, it must be emphasized again that any price floor which exceeds incremental cost can redound to the disadvantage of the entire economy by preventing the supply of useful services whose value to the members of the community exceeds the resources cost incurred in providing them. It is important to note, however, that this only requires the floors, and not necessarily the rates themselves, to be equal to incremental costs. The actual rate should normally be expected to exceed incremental costs by varying amounts whose magnitude depends upon the state of demand.

Section 4. Whose Costs Should be Used in Determining Price Floors?

Some persons have apparently been attracted by the idea that in setting minimum rates the costs which are relevant are not those incurred directly or indirectly by the carrier itself but are instead, at least in many cases, the costs of some other competing carriers. Typically this position has been associated with the phrase "cost of the low cost carrier." Behind such a view, there must lie reasoning such as the following: any rate which does not permit the viable and continued operation of the least expensive of a group of competitors must surely be destructive in effect, even if not in intent. But such an argument employs dangerous and misleading over-simplification. For example, it neglects the fact that one company may successfully out-compete another not because of its lower level of costs, but because of its superior product or its superior services, or because it makes possible a lower overall transportation expense to the shipper.

This line of reasoning has been used to support regulatory policies which are economically unacceptable both because it is impossible to implement even their own peculiar logic and because such policies can impose a heavy burden of inefficiency on the nation's transportation system.

It is impossible to implement a policy calling for rate regulation on the basis of the costs of "the low cost carrier" because there is no valid procedure which can identify the carrier whose operating costs are lowest. The costs of different modes of transportation are characterized by vast structural dissimilarities which for all practical purposes rule out meaningful comparison. For example, there is wide variation in the extent to which they make use of public facilities and thereby impose very real and significant costs on society—costs that are at best very poorly indicated by their accounts. In addition, the cost figures of one transportation mode may be becouded by interfirm relationships, thus making it difficult to determine what are its actual costs of providing the

service being priced. Where this situation exists, comparison of the costs of different modes is likely to be neither precise nor accurate. Moreover, as already indicated, a carrier may possess significant and relevant "inherent advantages" which encompass not only its operating costs but also the superior service which it provides to its customers and the savings in production and shipping costs which it makes possible for them. Such heterogeneous advantages can neither be evaluated nor compared by accounting methods or statistical techniques except after they have been tested by consumer demand. In sum, it is impossible to arrive at any acceptable comparison of the costs and advantages of the costs of different sorts of carrier. As a result, there is no way to implement any policy which attempts to set rates in terms of "the costs of the low-cost carrier" except on the basis of data that are arbitrary and that offer no valid information about the magnitudes which they purport to describe.

Equally important, any such policy can only serve to subvert a fundamental feature of any rational system of ratemaking which must take full account of the costs incurred by the carrier whose rate is under consideration, including, of course, public costs or costs borne by other firms associated in the operation. We have already seen that maximum profitability and optimal utilization require a calculation involving the incremental costs of the supplier. It follows at once that if these incremental costs of the supplier himself are neglected in the calculation, optimal results will be precluded. Not only will the carrier be forced to forego profits, but also, from the social point of view, inefficient use of the resources must be the inescapable result.

A system of regulation which bases the rates of carrier A on the cost of carrier B effectively disrupts the competitive process and its economic test of the efficient use of resources completely. It prevents the individual carrier from setting rates in accord with the profit motive so as to obtain any traffic whose incremental revenue exceeds its incremental cost. So long as its own costs are such as to per-

mit a profitable expansion of its traffic by means of a reduction in price, a carrier should be encouraged to undertake it regardless of the costs of its competitors.

By basing the rate of a carrier not on its own costs but on those of its competitors, an important source of motivation for improved efficiency of operation is eliminated. If reductions in its own costs of operation are not permitted to reflect themselves in reduced rates and thus in increased saleability of the service, there is that much less reason for concern with efficiency. Indeed, such a pricing procedure effectively protects the inefficient carriers who are otherwise unsuited to provide the services concerned. Moreover, it protects the latter at the expense of their more efficient competitors and of the body of consumers whose well being must surely be affected.

In sum, a regulated price calculation which bases the rates permitted one carrier on the costs incurred by another is absolutely indefensible in terms of economic analysis. It can lead to serious inequities and inefficiencies. This is true whether the cost calculation for the rival carrier is based on fully-distributed cost, out-of-pocket cost, incremental cost, or any other cost concept. The price charged by A should never be prevented from being lowered by any cost incurred by B, however appropriate the type of cost figure employed may be for other purposes. Logic and the desire for efficiency dictate that any restrictions on the prices or rates charged by any carrier be based only on the cost (and, it may be added, only on the incremental costs) incurred by that carrier itself.

Section 5. Objections to Fully-Distributed Cost Figures as Guides to the Setting of Mimimum Rates.

The position taken here is basically at variance with the view advocated in a number of quarters as to the appropriate cost concept for use in setting floors to the rates charged by carriers. It is proposed by some that a measure generally referred to as fully-distributed cost should guide regulatory agencies in their determination of rate minima. The

fully-distributed cost is a concept which has long been rejected by economists who have dealt with a similar measure under a slightly different name, "full cost." Economists have pointed out that the concept suffers from a number of fundamental deficiencies. Two of the most important of these are relevant here: its arbitrariness, which means that no full cost figure can be constructed in an unambiguous and fully justifiable manner; and second the fact that this cost concept is totally irrelevant to most optimality computations.

We have already seen why incremental cost, rather than some other cost figures, lies at the heart of any calculation which seeks to arrive at optimal decisions. Fully-distributed costs cannot tell the carrier whether it would gain or lose from raising or lowering rates or by increasing or decreasing its sales volume. Thus, in the normal course of business decision making, where the range of alternatives being considered ordinarily involves these possibilities, incremental cost figures usually provide all the pertinent cost information.

We have seen also how, in setting a price floor, the relevant question as far as costs are concerned is whether the contemplated level falls short of or exceeds incremental costs. This remains the crucial issue for the reasons which have already been given, regardless of the magnitude of fully-distributed costs. For carriers which charge a rate below incremental cost cannot normally be doing so in the pursuit of profit; whereas rates which offer any margin over incremental cost can be expected to occur in the normal operation of any carrier. It is for these reasons, then, that incremental and not fully-distributed costs are the costs which are pertinent to a determination of minimum rates.

As stated, the fully distributed cost concept is also objectionable on the ground that it is essentially arbitrary. In order to apportion fully the costs incurred by a carrier among the various services which it supplies, as is required by the full-cost concept, it is necessary to employ proce-

dures for which there can be no rationale except the fact that they yield numerical results. For in most normal economic operations, one encounters important classes of joint and common costs, that is, costs which facilitate the supply of two or more different types of service. For example, costs which are incurred in supplying both petroleum products and natural gas are of this variety because the outlays which are necessary to produce one of these products automatically facilitate the provision of the other. Similarly, in laying a track which will be used to transport one product, one automatically makes it possible to transport others as well; and in moving a train from source A to destination B, one makes it easier to move goods in the opposite direction. Such joint or common costs therefore are frequently encountered in industry as a whole and especially in transportation. And by the very definition of the fully-distributed cost concept, such joint or common costs must be fully apportioned among the services concerned in any fully-distributed cost figures. But by their very nature, such joint and common costs are not fully traceable among the services to which they pertain. Since these costs simultaneously serve a multiplicity of purposes, there is no way of saying in any valid sense what proportion of the cost appertains to any one of the services involved.

Eloquent testimony to the arbitrariness of the concept is provided by the wide variety of procedures which may be employed in making such allocations. They may be allocated in proportion to the volume of the revenues obtained from the services; in proportion to the out-of-pocket costs which they impose; or they can even be allocated equally among these various pertinent services. Economists agree that there is nothing inherently more correct in any one of these methods of allocation than in any other and that any price floor which is based upon such an arbitrary choice of allocation procedure must therefore, in the last analysis, be considered capricious.

It is to be emphasized that fully-distributed cost floors encourage the inefficient use of resources. They prevent

the utilization of facilities which might otherwise be usefully and profitably employed because their services can be sold at prices which exceed their incremental costs. Fully-distributed cost prices can also discourage modernization of equipment. For the accountant's conventional depreciation figure is normally subtracted from the sunk costs which are "fully-distributed" among the various segments of the carrier's operation. Since ancient pieces of equipment are usually largely depreciated, they place less of a dead weight burden on the pricing of items utilizing the services of such old and obsolete facilities.

Similarly, minimum rates based on fully-distributed costs constitute a drain on the carrier by preventing it from setting rates in accord with normal competitive principles. Such floors preclude the carrier from setting rates which maximize the contribution of each operation to company profits and overhead for they can prevent management from participating in the supply of some services which can yield returns in excess of their incremental costs and which are therefore capable of adding to the financial well being of the carrier.

Fully-distributed cost rates may not even succeed in attaining the objective which they may seem at first glance designed to achieve. Such rates cannot prevent a carrier from losing money because a rate sufficiently high to cover a calculated fully-distributed cost may effectively serve to deprive the carrier of the traffic on which the cost calculation was based. That is to say, if fully-distributed cost is calculated on the assumption that annual traffic will be T ton miles, the price needed to cover that fully-distributed cost figure may be so high that traffic proves to be substantially lower than T. And, as a result, costs per unit may turn out to be far higher than originally anticipated.

Finally, as I stated on another occasion, it should be recognized that fully-distributed cost floors to pricing essentially constitute a price support device and, thus, like any other such measure, fully-distributed cost price floors are directly

inimical to the interests of consumers. It is surely a delusion that the consumer can be protected by forcing him to pay prices higher than he would otherwise have done. It is a standard fallacious argument, whose ubiquity is not entirely accidental, which holds that the survival of a large number of firms is necessary to maintain competition, even if this must be done by means of artificial price supports. Clearly, such an arrangement retains the outward forms of competition and in the process destroys its benefits.

Section 6. **The Regulation of Destructive Competition.**

In sum, fully-distributed cost floors constitute an ill-conceived means for the prevention of destructive competition. We have already seen that price floors based on incremental costs do provide a substantial measure of protection in this matter. There is also another mechanism which would serve as a powerful device for dealing with the problem. Destructive practices can only be attractive to those who instigate them if the high prices which they intend to charge after they have eliminated their competitors are not somehow prevented. The appropriate way, therefore, to preclude such activity is to preclude its rewards. This could be accomplished by a requirement that a firm that initiates a price reduction may not raise its prices again unless such an increase is based on changed conditions other than the modified competitive situation—in other words, by letting a reduction in price constitute evidence that the firm can continue to operate viably at these lower rates in the absence of modified circumstances. The company would thereby be given notice that any price reduction must be fully justified in terms of its cost structure. For if in these circumstances it sets a price which is not viable and is forced to adhere to that price so long as its cost structure remains unchanged, it would suffer the appropriate consequences.

To summarize then, there is no justification for the use of artificially imposed price floors. While in the past some firms have been sufficiently ill advised to attempt to drive competitors out of business by means of temporary low and

noncompensatory prices, an artificial price floor set anywhere above the level of incremental cost is not called for as a means of dealing with such abuses. Rather, they can be prevented effectively by taking the profits out of such predatory acts and, if necessary, by the use of incremental cost floors to the pricing of the services concerned.

Section 7. **Economic Analysis and Incremental Cost Pricing.**

It has been stated at several points in this testimony that the views expressed are based on analytic materials whose validity is accepted by all economists of repute. The evidence on this point is so overwhelming that it requires no documentation. Any standard textbook chosen at random will indicate unambiguously the crucial role assigned to incremental costs in the pricing process.

Moreover, the fallacies inherent in fully-distributed cost pricing have long been known to the profession. This is nowhere better illustrated than in the following quotation taken from the writings of Gustav Cassel, a Swedish economist who, in the first decades of the century, was one of the world's most noted members of the profession. It should be observed that this passage, which so beautifully describes the pitfalls in the full-cost-pricing argument, was published in 1900. Cassel's discussion, which is summarized in tabular form below, is contained in the following admirably lucid statement:

> "Let us suppose that a travel agency has ordered special trains for a number of Sundays and has contracted to pay 250 *mark* for each train. Each train was was to provide 400 seats, all third class. The first Sunday the agency charged 2 *mark* and 125 excursionists bought tickets. The gross receipts amounted to 250 *mark* or to exactly as much as the outlays. The managers of the agency then said to themselves: 'at this price we can only just cover our own costs, but we must also earn something,' and they raised the fare to 3 *mark*. On the next Sunday only 50 people bought tickets. The result was takings of 150 *mark* and a net loss of 100 *mark*. The agency then

reasoned: 'average costs amount to 5 *mark* per person and we carry each passenger for 3 *mark;* we cannot go on like this.' The price was raised to 6 *mark* with the result that on the next Sunday the train carried only 6 passengers. The loss rose to 214 *mark.* Now at last the managers of the agency said to themselves: 'this story of costs must be sheer nonsense, for it only ends in losses.' So they reduced the price straight away to 1 *mark.* The result was brilliant: 400 passengers turned up the next Sunday, a profit of 150 *mark* was earned and, strangest of all, costs had fallen to 0.625 *mark* per head."

It would be difficult to find a clearer explanation of the fallacies inherent in the view that fully-distributed cost pricing can guarantee the profitability of a carrier. This passage also suggests how long and how widespread has been the acceptance among economists of the principles described in this testimony.

TABLE I

CASSEL'S FULLY-DISTRIBUTED COST EXAMPLE (1900)

Total Cost	*Fare* (Mark)	*Number of Passengers*	*Fully Distributed Cost* (Mark)	*Profit or Loss* (Mark)
$250	2	125	2	0
250	3	50	5	-100
250	6	6	42 (Approx)	-214
250	1	400	0.625	150

SOURCE: Gustav Cassel, "The Principles of Railway Rates for Passengers," *International Economic Papers,* No. 6., translated from *Archiv für Eisenbahnwesen,* 1900.

Section 8. Summary and Conclusion.

The preceding analysis sets forth in outline the logic of the relationship between costs and calculations pertinent to the setting of minimum rates for railroad services. It has been shown that the only costs which are always pertinent

to the pricing of the services or of any carrier are the direct or indirect costs of that carrier itself. Second, it has been shown that the appropriate cost concept is incremental cost and not fully-distributed cost or any other such arbitrary construct. Third, it has been argued that minimum rate floors which violate these two pinciples impose burdens upon consumers, reduce the earnings of the carriers, lead to the inefficient utilization of resources and, in general, interfere with the workings of the free enterprise system.

It can never be denied that some regulation of business practices is necessary to prevent occasional abuses. But, surely, it is desirable that these regulations restrict themselves exclusively to the elimination of those abuses. Our system of private enterprise requires that management be given as much scope and freedom for its decisions as is consistent with the prevention of untoward activities. In the case of railroad rates, there is every reason to believe that the interest of society and the economy would best be served by permitting the carriers to lower their rates whenever this is required for the maximization of profit subject only to the limitation that these rates never fall short of incremental costs and that temporary rate reductions designed to destroy competitors be precluded in the manner already suggested. It appears clear that no other restrictions on rate reductions are normally justified.

THE ROLE OF COST IN THE MINIMUM PRICING OF RAILROAD SERVICES

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THE ROLE OF COST IN THE MINIMUM PRICING OF RAILROAD SERVICES

[*Editor's note.*—Over the past fifteen years, settled patterns of regulation of transport rates and services have been subjected to increasing scrutiny and criticism not only from academic economists but also from producers and users of transportation, public officials, and the public in general. The largest single reason for this heightening of interest has been the increasingly severe competitive and financial position of the railroad industry. While the operation and regulation of any one mode of transportation cannot be considered in isolation, much of the present discussion of transport regulation properly centers on the railroads. An important topic has been the search for regulatory principles and procedures which would yield the maximum public benefit from railroad plant and technology under present competitive conditions.

The following statement was prepared under the auspices of the Association of American Railroads, an obviously interested party and one that has done much to stimulate broad interest in the regulatory problems of its members. The statement represents a consensus of ten economists, most of whom will need no introduction to readers of this *Journal.* It is published here as a contribution to the discussion of the business and regulatory economics of transportation and of other industries, both within and outside the public utility field. Specifically, the panel of economists undertakes to clarify the economic principles of costs that are relevant as a guide to the pricing of particular railroad services. The statement, concerned with basic concepts of costs, should help to provide an essential groundwork for the development of improved techniques for the measurement of relevant costs in specific situations.]

FOREWORD

Recognizing the growing attention to cost considerations in railroad rate-making, the Board of Directors of the Association of American Railroads requested Burton N. Behling, Economist, Bureau of Railway Economics of the Association, to arrange for a study of the relevant concepts in determining cost floors for rates and to seek the advice and

counsel of a group of outstanding and disinterested economists in this matter.

To collaborate with him in this undertaking, he engaged the following distinguished consultants:

William J. Baumol, professor of economics, Princeton University, and member of Mathematica

James C. Bonebright, professor of finance, emeritus, Columbia University

Yale Brozen, professor of business economics, Graduate School of Business, University of Chicago

Joel Dean, professor of business economics, Columbia University, and economic consultant, Joel Dean Associates

Ford K. Edwards, transportation consultant, Edwards and Peabody

Calvin B. Hoover, professor of economics, Durham, North Carolina

Dudley F. Pegrum, professor of economics, University of California at Los Angeles

Merrill J. Roberts, professor of transportation, Graduate School of Business, University of Pittsburgh

Ernest W. Williams, Jr., professor of transportation, Graduate School of Business, Columbia University

They began their task early this year, and the results of their work are now presented in the attached statement entitled "The Role of Cost in the Minimum Pricing of Railroad Services." All the participants "subscribe to it in substance and they specifically agree with the conclusions as set forth in the summary at the end of the statement."

ASSOCIATION OF AMERICA RAILROADS
WASHINGTON, D.C.
July 27, 1962

INTRODUCTION

Increasing competitiveness in transportation has stimulated debate regarding the principles which should guide the determination of any floor below which particular railroad rates will not be permitted to fall. A central issue in this debate is whether particular rates should be cost or market oriented. This statement examines the issue—bringing to bear accepted principles of economics that apply throughout the economy. It sets forth the role of cost in pricing and in so doing shows that prices must be *both* cost and market oriented.

Examining first the basic cost concepts and then the nature of railroad costs, the analysis concludes that incremental costs provide the valid cost guide for minimum pricing and that "fully distributed" costs must be rejected as an economic test of any particular price or rate. These conclusions are reached by reference to the interest both of the pricing carrier and of society as a whole, and they have the same force and relevance for pricing within modes of transport as among modes.

UNDERLYING COST PRINCIPLES

The increase in total costs resulting from an expansion in a firm's volume of business is commonly referred to as *incremental cost.* This cost is of vital economic significance. For the businessman it provides an essential guide to his production and pricing policy. If he is considering a reduction in price, he needs to know whether the increase in total revenues from greater volume will more than cover the additional costs that will be incurred. For the whole economy it is incremental (not fully distributed) cost that is the relevant cost guide to how much of what shall be produced and how much should be invested in various lines of production. This cost, which is measured by the value of the additional resources that will be used up when more of anything is produced, represents the real cost to society.[1]

[1] Social costs which are escaped by the enterprise must also be included in the calculation.

Incremental costs indicate (by comparison with the incremental revenues they will bring) whether additional outputs of any commodity are worth producing and (by incremental cost comparisons) which of the alternative ways of satisfying wants or requirements is the most efficient.[2]

But not all costs can be identified causally with specific quantities of production. Much of the controversy over cost concepts stems from the false notion that all costs can be traced and attributed to specific blocks of output. Although many costs are *traceable,* there are also *non-traceable* costs which simply do not lend themselves to this method of identification:

a) Fixed costs.—Some costs, called *fixed costs,* do not change in magnitude when the quantity of output for a given plant varies. Hence, it is impossible to assign any specific portion of these costs to a particular unit of output (e.g., to a particular ton-mile of traffic). Rather, a fixed cost must be imputed to the entire supply of the type or types of service with which it is associated.

b) Joint costs.—Different services may sometimes share their costs, as, for example, when the same roadbed is employed to transport both food products and lumber.

Such common and joint cost conditions are frequently encountered in the railroad industry as well as elsewhere. Wherever incremental costs are also either joint or common costs, the resulting difficulties of allocation cannot be sidestepped. Here the standard distinction between common costs and joint costs can have practical importance. *Common costs* are outlays devoted to either of two or more classes of services which may be variably proportioned at the discretion of management, with the result that it is, in

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[2]In addition to those costs which vary with rate of output for a given investment level, incremental costs include cost increments associated with new investment. For example, if special equipment is acquired in order to handle certain additional traffic, the costs are incremental to that traffic.

principle at least, possible to trace them to individual services. *Joint costs,* in contrast, are costs for which the proportions of output are not variable, so that supplying one class of service in a given amount results automatically in making available another class of service in some unalterable amount. The practical consequence is that incremental joint costs are not traceable to individual railroad services and can be allocated only arbitrarily. In contrast, those common costs which are incremental are traceable in principle, although it may be impossible over a considerable range to do so in practice.

For any business or industry there is no rigid division between variable costs and fixed costs. Some cost elements which are fixed in the very short term or with small changes in output may over a somewhat longer period or a broad range of output become incremental if additional investments or other inputs are required. However, an indefinitely long-term view of incremental costs is not appropriate, for some fixed costs may be expected to remain fixed over any time period and range of output that is reasonable to consider in setting a price floor. Depending on the particular circumstances, incremental costs might contemplate a range of short terms. The only general rule for deciding which measure of incremental cost to use as a *cost* guide for minimum pricing is that the choice of incremental cost functions must be geared to the duration of the expected revenue change.[3]

Each particular situation requires its particular cost analysis by management. For example, a cost structure will be affected significantly by the extent of unused capacity in the production factors involved. Where unused capacity is substantial and persistent, the fixed cost elements per unit

[3]More specifically, the decision is governed by such revenue dimensions as the nature and amount of the contemplated change in volume, the length of the commitment to carry the traffic, the duration and geographic scope of the changed rate, the alterations of the service that might require added investments, and the time period in which changes may legally or practically take place.

of output are correspondingly greater and more enduring, and the incremental costs proportionately smaller.

Arbitrary apportionments of non-traceable costs among particular kinds of outputs must be employed in the calculation of "fully distributed costs." This measure will be further considered later in particular reference to railroad rate-making. However, it is apparent from what has been said that fully distributed costs have no true economic content because their derivation falsely assumes that all costs can be traced to particular kinds or quantities of output and can rationally enter directly into pricing decisions. The greater the degree of non-traceable costs, the more inappropriate is the use of fully distributed costs as a guide to minimum prices.

NATURE OF RAILROAD COSTS

Fixed costs, which are independent of volume and are not attributable to specific amounts of traffic, are an important characteristic of railroad cost structures. Large portions of railroad investment costs represent expenditures for long-lived facilities that have been "sunk" in the enterprise at various times in the past. The facilities involved are of such specialized nature that they are not generally transferable to other pursuits without great loss. Fixed costs associated with sunk physical investments, as well as organizational or other cost factors which are underutilized, are irretrievably committed to an essential public service unless disinvestment, organizational shrinkage, or, as a last resort, abandonment occurs.

Because of the long but varied lives of their facilities and the inherent uncertainties of forecasting, adjustment of railroad capacity to charging requirements is difficult. Unutilized railroad capacity is a chronic problem which demands effective steps to retain existing traffic and to attract additional traffic. Moreover, railroad investments in recent years which were intended for modernization and greater efficiency have in many instances also increased capacity, although this has not usually been the purpose. Significant techno-

logical improvements include heavier rail and track structures, electronic yards, centralized traffic control, and better communications, as well as improved locomotive power and higher-capacity freight cars. Realization of the potential economies of these and other interrelated improvements depends on large and increasing traffic volumes.

The railroads own, and hence must fully pay for, the costly plant facilities they use. In contrast, highway, water, and air carriers use publicly owned rights of way and facilities. To the extent that they repay the economic costs of these facilities furnished to them, their payments are mainly through use charges which make their costs of this sort predominantly variable. For these and other reasons, these rival carriers can adjust their capacities to fluctuating demand more promptly and precisely than can the railroads.

The rapid growth of electrical utility volume has been due to a steady reduction of real prices on average and to promotional pricing designed to utilize capacity effectively and to expand sectors of demand that are price-elastic. These achievements have been made possible, on the cost side, by sustained technological progress and economies of scale in the generation and transmission of electricity and, on the demand side, by strong markets and commendable regulatory insight. This kind of economic performance, generally regarded as serving the public interest, is no less socially desirable for the railroads. And even though it is more difficult to attain because of their highly competitive environment, such performance is at least equally urgent because of the railroads' financial plight.

The public interest requires maximum economic utilization of the vast capacity of the railroads' plant and operating organization. To this end it is essential that the burden of fixed costs be spread over as large a volume of traffic as can be developed with attractive rates in excess of the relevant incremental costs. This mode of operation is desirable not only for the railroads in providing them with the opportunity for reasonable investment returns. It may also

be advantageous to the shippers in lower shipping costs. Above all, it is in the public interest because it provides the maximum amount of transportation service for the resources which are employed for this purpose.

RELEVANT INCREMENTAL COSTS

In determining incremental costs, it is necessary to distinguish between sunk and prospective investments. Sometimes the pertinent incremental costs involve making added investment (e.g., cars or locomotives). In that event all the added costs to be incurred (including use-depreciation and cost of capital) should be recognized as incremental. Sometimes capacity is so excessive that the traffic at issue can be handled without added investment. The investment costs then are sunk and may become fixed for long periods. Once the commitment has been made, and if a plethora of capacity subsequently develops, the recovery of anything more than incremental cost is better than nothing.

Prudent railroad management should certainly be aware of the threat to long-term profitability, and even survival, from fixing rates on a substantial proportion of traffic near strictly short-term incremental costs. Nevertheless, in the complex and varied circumstances of the railroads, there will be some situations where pricing of particular services on the basis of short-term considerations will improve utilization and will yield accretions to net income not otherwise obtainable. In view of their primary responsibility to make effective use of their vast facilities through volume retention and developments, railroad managements require considerable latitude in estimating relevant costs as well as in pricing decisions. There is no single cost formula which will always and automatically be appropriate.

In rapidly expanding industries operating with short-lived facilities and highly flexible organization, recognition of the transitory nature of fixed costs and their tendency to be transformed rather quickly into incremental costs is an essential costing precept for pricing purposes. But railroad costs cannot be cast in such a simple mold. The reality of

their fixed costs cannot be made to disappear with a general assumption of variability with traffic volumes if the time period is stretched out long enough. With the persistent and serious under-utilization of capacity which is characteristic of the railroads' basic plant and organization, large amounts of fixed costs remain fixed indefinitely. The least effective way to cope with unutilized railroad capacity would be to include its fixed costs in floors for pricing. For the high prices which would result could only discourage utilization of these facilities and aggravate the condition.

Neither extremely short-run nor extremely long-run incremental cost is an economic concept of general applicability to all minimum pricing problems encountered in the railroad industry. The determination of the relevant incremental costs appropriate for a particular pricing decision is not simple[4] but must reflect complex railroad cost conditions that arise from persistent excess capacity, irrelevant fixed-cost elements, and such interrelated dynamic factors as changing volume, changing labor and material costs, technological innovations, and improved operating techniques. Where such dynamic forces are at work the incremental costs of additional traffic, which may be induced by a reduced rate, may be quite different from those indicated by past experience.

[4] The relevant incremental costs are a function principally of the prospective volume in relation to present volume and utilized capacity in existing plant and organization. The rate over time at which the prospective volume is likely to be achieved, the prospects for its continuance over the longer term, and its distribution over stated time periods (for example, seasonality and peaking characteristics) are all relevant to the determination of appropriate incremental costs. From consideration of the prospective volume and its characteristics it may be feasible to estimate those elements of plant and organization which will require ultimate replacement, allowances for the use of which should figure currently in costs. If volume promises to build up substantially over time, the likelihood and cost of the required expansion in capacity must be recognized in the computation of the price floor.

More penetrating analysis of specific cost elements is needed for a better understanding of their relationship to traffic volumes. Such analysis, which is beyond the scope of this statement on cost concepts, should be intensified by the railroads. Particularly urgent is the need for cost determinations which are "tailored" to specific situations instead of the commonly used general measures which are vitiated by excessive averaging.

COSTS AND PRICING

Forward-looking costs are essential because the pricing decisions they must guide necessarily look to the future. The estimation of such costs must reckon with changes in operating techniques which may result from expanded volume and associated or unassociated technological innovations. Because of these factors, historical experience provides no sure basis for determining those future incremental costs which alone are relevant in setting price floors.

As a general rule, any rate below incremental costs is both unprofitable and socially wasteful of resources because the additional (incremental) revenue obtained is less than the additional cost incurred.[5] However, this does not mean that the railroads should set rates *at* that cost level or that they should be required to do so. On the contrary, this cost reference is uniquely important as a guide in determining the specific rates which will provide the maximum contribution to the overhead burden and thus to net income. The margin above incremental costs which maximizes this contribution depends upon the price sensitivity of demand, deter-

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[5] The application of this principle in particular situations may require special care in estimating the pertinent incremental costs and incremental revenue. Especially in the short run they may be different from what they superficially appear. Example: the hidden incremental costs of dismissing and later reassembling a key work-force; and the hidden, foregone incremental revenue that may result in losing a profitable customer by refusing to take an occasional order below incremental cost.

mined primarily by the alternatives available to shippers. The judgment of management should be relied upon to make this determination, subject to limitations imposed by regulation of maximum rates and discrimination. Thus, while incremental costs should not *determine* prices or rates, they set the lower boundary (and demand conditions and regulation the upper boundary) within which pricing decisions should be made.

Railroads produce a multiplicity of different services in many markets with dissimilar demand characteristics. For example, the demand for the transportation of coal for three hundred miles eastbound may be entirely different from the demand for the transportation of the same commodity three hundred miles westbound because of competitive or market incluences. Basing rates on demand (as well as on incremental costs) to attain the maximum contribution means, therefore, that rates for all services will not be the same either absolutely, or in relation to cost, or in contributions to the net income of the carriers.

Since demands for rail services have become increasingly elastic as alternative means of transportation (both for-hire and private) have become ever more available, the greatest total contribution to net income will for many items and hauls result from a low unit margin above incremental cost and a large volume. Estimating the volume of traffic which might move at different levels of rates and the effect on net income is a key aspect of pricing. This vital function is a primary management responsibility which should be performed on the basis of managerial and not regulatory judgment. Rates so determined, however, can legitimately continue to be subject to regulation of maximum rates and to legal rules against unjust discrimination.[6]

[6]The railroads also are subject to the limitation of a reasonable over-all "return," but this regulatory limitation has not for many years of low earnings been a matter of real concern. If excessive profits were ever achieved, it would be the lawful responsibility of the regulatory authorities to apply the appropriate restraints.

Differential pricing is consistent with the public interest in the economical utilization of resources. It can yield significant benefits to the users of rail services by encouraging the retention of traffic and the development of greater traffic volumes and improved profits, thus fostering the adoption of improved technology and service, as well as lower rates.

Pricing designed to achieve such results should not be condemned as "destructive" or "unfair" competition. Rather it is necessary for constructive competition and maximal economy and efficiency in the utilization of resources. By the very nature of competition some are hurt by it. It may well be that realistic assessments of incremental costs as a pricing guide would encourage rate reductions where carrier or regulatory policies have stressed preservation of historic rate structures or keeping rates high enough to maintain "fair" market sharing. Indeed, reductions designed directly to improve profits may do so mainly by shifting traffic away from firms operating by other modes, which are thereby hurt or even destroyed. But this does not constitute predatory competition. Predatory practices must be taken to refer to temporary price reductions designed to eliminate competition in order to clear the way for high and monopolistic rates in the future. Ease and low costs of re-entry of trucks and other modes make predatory competition by the railroads unprofitable and hence unlikely. Moreover, such undesirable practices constitute a legitimate concern of the regulatory authorities. Regulatory powers should not, however, be used to prevent price reductions which are designed to improve or maintain profits by increasing or retaining traffic volume. Such prevention is particularly undesirable socially, because of the low rates of utilization of the large property investments of the railroads.

"FULLY DISTRIBUTED" COST AN INVALID BASIS FOR MINIMUM PRICING

The relevant incremental costs constitute all the cost information pertinent to the determination of floors in the pricing of particular railroad services. "Fully distributed" cost, measured by some kind of arbitrary statistical apportionment of the unallocable costs among the various units or classes of traffic, is an economically invalid criterion for setting minimum rates, from both a managerial and a regulatory standpoint. No particular category of traffic can be held economically responsible for any given share of the unallocable costs. Whether any particular rate is above or below some fully distributed cost is without real economic significance for minimum pricing.

Stated differently, the appropriate aim of the railroads is to determine that margin above incremental costs, traffic volume considered, at which a rate produces the maximum total contribution toward fixed costs and net income. Fully distributed costs cannot serve this vital economic purpose. They present an entirely false picture of traffic profitability. Their use would drive away great quantities of profitable, volume-moving traffic now handled at rates below fully distributed costs.

Another misconception is the view that if some railroad rates are below fully distributed costs a burden is imposed on other traffic which must pay more to make up the "deficiency." But, when the true significance of unallocable costs is understood, it becomes apparent that a particular rate which maximizes the contribution to such costs over and above the relevant incremental costs cannot possibly burden other traffic even though rates on the latter may be higher. If such contributions from lower-paying traffic were lost because of unattractive rates, railroad earnings and expenditures for improvements would suffer, and the ability to provide good service would be impaired. Traffic which is not moved cannot possibly help to bear the unallocable costs. It is the fully distributed cost doctrine which, by

pegging minimum rates on a false economic premise, would burden not only railroad shippers but the economy as a whole and would tend to bankrupt the railroad system by artificially restricting the economic use of railroad facilities and services.

Especially in competitive industries, no cost system can really assure that all costs will be covered and a "normal" profit earned, for sales volume will play a significant role. If guaranteed coverage of all costs and a normal profit are the objectives of fully distributed cost pricing, it cannot succeed. For that matter, neither can pricing based on relevant incremental costs plus a maximum contribution to fixed costs and net income, as determined by conditions of market demand, provide such a guarantee. But if these contributions are maximized throughout the pricing structure, the best result has been achieved and no further improvement is possible under prevailing market conditions.

Thus, the fully distributed cost doctrine does not reflect valid principles of pricing, where fixed costs are significant. Application of this false criterion in the railroads' present competitive environment would bring about prices which (for much traffic) would shrink volume. If the same total constant costs were then distributed on the shrunken traffic volume, even greater fully distributed unit costs would result, and if this should cause the railroads to raise rates still higher relative to the prices of other modes of transport, then rail traffic volume would probably be still further reduced. A costing procedure which can inaugurate such a destructive cost-price spiral is not qualified to serve as a basis for pricing in the railroad business or in any other with unallocable costs and unused capacity.

The social costs of such a pricing method could be enormous. The railroads could not function economically and quite possibly could not survive the use of this misguided basis of pricing. Under it, much traffic either would not move at all or would be moved only by modes of transportation with higher actual economic costs. The end result

would be a greater total transportation cost borne by the whole economy in return for a reduced total volume of transportation service.

"FULL COST OF LOW-COST CARRIER" ALSO A FALSE STANDARD

An offshoot of the fully distributed cost fallacy is the contention that rail rates should not be permitted to go below the "full cost of the low-cost carrier" (such carrier being determined on the basis of comparative fully distributed cost), whether it be that of railroad or a different mode of transport. This contention, also, has no validity as a measure of "inherent advantage" or relative economy in the utilization of economic resources of the nation. For the reasons pointed out above, the low-cost carrier is properly identified by incremental cost, not by so-called "full" cost.

Only a railroad's own incremental costs are of any significance as a guide in establishing its minimum rates; and this same principle applies as well to other modes of transport and other industries. Imposing a different and higher *cost* standard deprives railroads of traffic which they can transport more economically, artificially stimulates the growth of uneconomic transportation by other means including private transportation, deprives the shipping public of the benefits of low-cost service, and imposes higher commodity prices on the consuming public. However computed, the use of fully distributed costs would be wasteful of economic resources by misdirecting their use and by keeping them idle or underutilized.

In addition to its inherent defect, this specious "cost" proposal has another deficiency. To whatever extent carriers which operate on public facilities may not have to meet full economic costs in conducting their business, their "fully distributed costs" are not consistent with those computed for the railroads. For the railroads a fully distributed cost computation embraces the entire costs. The effect of the use of the "full cost of the low-cost carrier" doctrine is to obstruct the railroads in pricing their services in com-

petition with other modes to the extent that they may be subsidized. Thus, this proposal constitutes umbrella rate-making to protect any subsidized modes of transportation from legitimate competition by the railroads.

SUMMARY

1. In the determination of cost floors as a guide to the pricing of particular railroad services, or the services of any other transport mode, incremental costs of each particular service are the only relevant costs.

2. Rates for particular railroad services should be set at such amounts (subject to regulation of maximum rates and to legal rules against unjust discrimination) as will make the greatest total contribution to net income. Clearly, such maximizing rates would never fall below incremental costs.

3. Pricing which is not restricted by any minimum other than incremental cost can foster more efficient use of railroad resources and capacity and can therefore encourage lower costs and rates. This same principle applies to other modes of transportation.

4. The presence of large amounts of fixed costs and unused capacity in railroad facilities makes it especially important that railroad rates encourage a large volume of traffic.

5. Reduced rates which more than cover incremental costs and are designed by management to maximize contribution to net income do not constitute proof of predatory competition.

6. "Fully distributed" costs derived by apportioning unallocable costs have no economic significance in determining rate floors for particular railroad services. The application of such a criterion would arbitrarily force the railroads to maintain rates above the level which would yield maximum contribution to net income and would deprive them of much traffic for which they can compete economically. For similar reasons, restriction of railroad minimum rates according to the "full cost of the low-cost carrier" is economically unsound.

The undersigned economists and transportation specialists have issued the foregoing statement on the role of costs in railroad rate-making. All the signatories subscribe to it in substance, and they specifically agree with the conclusions set forth in the summary at the end of the statement.

/s/ William J. Baumol
William J. Baumol

/s/ Burton N. Behling
Burton N. Behling

/s/ James C. Bonbright
James C. Bonbright

/s/ Yale Brozen
Yale Brozen

/s/ Joel Dean
Joel Dean

/s/ Ford K. Edwards
Ford K. Edwards

/s/ Calvin B. Hoover
Calvin B. Hoover

/s/ Dudley F. Pegrum
Dudley F. Pegrum

/s/ Merrill J. Roberts
Merrill J. Roberts

/s/ Ernest W. Williams, Jr.
Ernest W. Williams, Jr.

July 10, 1962

Exhibit No: 39

STATEMENT OF JAMES M. BUCHANAN

Cost Considerations in a Regulatory Framework

Section 1. **Introductory Personal Statement.**

My name is James M. Buchanan and I hold the Paul G. McIntire Chair in Ecomomics at the University of Virginia, where I also serve as Director, Thomas Jefferson Center for Studies in Political Economy. I have been on the faculty at the University of Virginia since 1956. I have also taught at the University of Tennessee, Florida State University, and Cambridge University in England. On various occasions in past years, I have served as an economic consultant with the Committee for Economic Development, the RAND Corporation, the Treasury Department, the Council of Economic Advisers, and numerous other agencies, both public and private. I have written six books in the field of economics, including two basic textbooks, and I have published some fifty professional papers. Included in this material have been technical papers on the relation of incremental costs and prices, both in terms of general economic theory, and in particular reference to railroad service and highway service pricing. I am immediate past president of the Southern Economic Association.

This statement will discuss general economic principles as these pertain directly to rate making in transportation. It is not intended to and it does not attempt to discuss the historical and institutional details of rate regulation. The statement is an application of economic analysis.

Section 2. **Incremental Cost Considerations.**

The Interstate Commerce Commission is responsible for the preservation and promotion of the inherent advantages of the various transportation media within the framework

of an integrated and coordinated national transportation policy. This objective may be translated into economic terminology by saying that the Commission's responsibility is the prevention of the abuses that might arise to inhibit the development of an efficient transportation system.

Pertinent questions arise concerning the definition of an "efficient" system. Presumably, efficiency should be interpreted here in a manner similar to that generally employed in analyzing the performance of the national economy.

It has long been an established tenet of national policy that unregulated competition is not allowed to exert controlling influences over the transportation economy, to the extent that prevails in other sectors. For purposes of declared national interest, public regulation has been introduced and maintained to replace, to a partial extent, free and open competition as the instrument that will insure economic efficiency.

The principle for promoting economic efficiency through regulation is that of producing results that are similar to those that would emerge from a competitive structure. Essentially, therefore, the aim of regulation should be that of allowing the transportation sector to respond as fully as possible to the forces of the market economy, while preventing abuses that are known to generate serious inefficiency. In carrying out this aim, the developments in the transportation industry that have increased effective and potentially effective competition should not be overlooked. To the extent that potentially effective competition emerges, the positive need for direct regulatory action in control of abuses may be reduced.

The following questions become germane: (1) What are the relations between prices and costs in an effectively working market? (2) What conception of cost is used to guide decision-making in the competitive sector?

Perhaps the most widely accepted principle in formal economic theory states that, for purposes of making rational decisions, sunk costs should not be considered and that mar-

ginal or incremental costs, appropriately measured, are the only relevant costs. In a competitive industry, business firms must make decisions on the basis of incremental costs if they are to survive; any attempt to make pricing and output decisions on the basis of full costs or fully-distributed costs would insure eventual bankruptcy.

The testimony submitted by Professor William J. Baumol has emphasized the necessity of utilizing incremental cost considerations in the regulatory process which grants approval of rail freight rates. The theorems applied by Professor Baumol to this particular problem are strictly within the corpus of accepted economic theory, and I know of no professional economist who would dispute these theorems.

The question that remains is: Are there features peculiar to rail transport, or to transportation in general, which suggest a departure from orthodox economic principles? Three possible arguments for applying something other than incremental costs as the basis for decision-making will be examined.

1. It might be argued that some departure from the strict application of incremental costing principles, narrowly conceived may be justified to the extent that the incremental costs, as these are calculated by the carrier, do not accurately or properly reflect the genuine incremental costs *to the whole community.* In other words, it could be argued incremental cost considerations should be more inclusive than those borne by the carrier in question. In particular application to rail freight rates, this argument seems clearly to be irrelevant. For competing media, such as trucking firms, where no explicit charges are made for congestion that is created by their activities over publicly-owned rights-of-way, the incremental costs borne by the carrier may fail to reflect fully the "social costs" incrementally imposed on the whole community. Similar conclusions follow with respect to barge-line operations where firms are not required to pay user charges for publicly-supplied facilities. In any comparative sense, the incremental costs borne by railroad

companies approximate genuine "social costs" more closely than those which apply to competing media.

2. A second argument for departing from orthodox economic precepts might be advanced if it could be shown that the use of incremental costs as the basis for setting rate floors serves to produce "unjust discrimination," something which is explicitly prohibited in the statement of National Transportation Policy.

But what is "unjust discrimination"? The economist cannot, of course, determine what is or what is not "just" or "unjust" in an ethical sense. Economic theory can, however, make appropriate distinctions between those changes in rate structures that lead to greater efficiency and those that lead to less efficiency. In these terms, arbitrary *increases* in rates to particular groups of users, i.e., increases that serve to *reduce* the flow of traffic on segments of the system create inefficiency. By contrast, the introduction of additional flexibility in rate structures by allowing some rates to move toward levels indicated by incremental cost floors serves to bring additional traffic into being, while increasing rates to no users of the service. Again, it is a familiar principle of economic theory which states that, to the extent that additional traffic is generated as a result of rate reductions of this nature, the output of the supplying industry moves closer to national "optimum" or "efficient" level. The allocation of the nation's resources will be improved, rather than worsened, in accordance with the standard criteria, by the introduction of such "market-extending" flexibility in rate structures, based on incremental cost floors. It seems evident that this sort of flexibility in a rate structure does not constitute "unjust discrimination," if any meaningful economic content is to be given to this term. Therefore, the prohibition of "unjust discrimination" does not involve any departure from the use of the incremental cost standard in making decisions on the rate structure.

3. A third possible argument against the application of orthodox economic precepts concerns the possibility that

the full implementation of incremental costing as the basis for rate floors might introduce "unfair or destructive competitive practices." This argument introduces directly the relation of the rate structure of rail carriers to the position of competing carriers.

As Professor Baumol has pointed out in this testimony, the incremental costs confronting the railroads also approximate very closely the incremental costs for this sort of transportation activity to society as a whole. If, therefore, additional traffic can be shifted to this medium by lowered rates within the limits imposed by incremental cost floors, there is a total gain to society, even should all of the additional traffic be drawn from the custom of competing media. The failure to allow such traffic-generating rate reductions amounts to making society pay more than is necessary for the transportation services that it requires. And the unnecessary extra payment represents socially unjustified monopoly gain, even if firms in the transportation industry do not make monopoly profits. In this case, the gain is absorbed by the maintenance of inefficient traffic patterns, patterns that would be eliminated by the introduction of additional rate flexibility.

In so far as the incremental cost basis for setting rate floors is accepted for one medium, it should, of course, be accepted also for all other media. And if, in fact, a threatened diversion of traffic to railroads is not "efficient" in the overall sense, this will be demonstrated by the evidence that incremental costs on competing media will be lower, not higher, than those on the railroads. There is nothing unique about the applicability of incremental cost floors to railroad transport. The principle is a universal one, applicable to any industry, whether regulated or unregulated.

On the criteria of national economic efficiency, if an industry supplying a service cannot survive and remain profitable in the presence of incremental cost floors imposed on its pricing structure, it should not be supported by regulatory agencies charged with maintaining the inherent ad-

vantages of the various media. In such a case, there is simply no inherent advantage to the inefficient media, and efficiency considerations dictate their abandonment. To argue otherwise is to equate the inherent advantage norm with the promotion of resource waste in transportation.

This point can easily be illustrated with simple examples. The diesel locomotive has replaced the steam locomotive, almost completely, because it is the more efficient engine. The steam locomotive simply possesses no inherent advantage in a modern railroad system. Essentially the same logic must be applied to any consideration of the integrated transportation network, or even to the whole economy. Some media may, at any particular period of time, become inefficient as a result of technological progress and economic change. The covered wagon as a mover of freight was replaced completely. It is impossible to judge which medium possesses "inherent advantages" except in so far as the results of properly applied and implemented pricing policies are allowed to emerge in the normal order of events.

It is impossible to determine "inherent advantage" in advance of results through some application of arbitrary formulas. Attempts to prejudge such advantages on some non-economic basis, and to make regulatory decisions thereupon, tend to prevent the emergence of the very results which are, in fact, required for economic efficiency. Thus, the irony is that the use of false norms may prevent the attainment of the objectives that the whole regulatory structure is designed to achieve.

This is not to deny, altogether, that "predatory competitive practices" can exist, and do exist in some instances, although these are less common than is often thought to be the case. As Professor Baumol has correctly indicated, genuinely predatory practice (which must involve pricing below incremental costs with the aim of driving out competitors), must, in the nature of the case, inflict losses on the predatory firm. Such a practice is, moreover, largely unprofitable to the firm that attempts it, even over the long run, until

and unless this firm, also, can effectively prevent competing firms from re-entering the industry from which predatory competition drives them initially. This would imply, in the case of railroad rates, that successful predatory policy requires rather complete monopoly controls over entry into all competing transport media. Surely, the presence of the overall regulatory framework insures that railroad management would have little, if anything at all, to gain from predatory practices in the modern transportation system. Even if a railroad should, successfully, drive out competitive firms in a particular area of service by accepting unprofitable business for some short period, this railroad could not expect readily to recoup these short-term losses because it could not, in any way, control or prevent the re-entry of new competitive firms when rates were again increased, even should such increases be allowed by regulatory authorities. Given the ease of entry into both barge and road transport, the attempts to exploit monopoly gains to offset initially-incurred losses from predatory practices would quickly re-attract resources into competing media. In sum, the possibility of predatory price-cutting as a profitable undertaking for the modern railroad seems remote indeed. And, to the extent that this possibility may arise in the isolated instance, the prevention of rates from falling below incremental cost levels would be sufficient to forestall all dangers of such predatory behavior, whether rationally or irrationally motivated.

It is clear that none of the three arguments examined justifies any departure from the application of orthodox economic principles which require that regulatory decisions on railroad freight charges be based on incremental cost considerations.

Section 3. Incremental Costs and Full Costs.

In the preceding section, I have demonstrated that there is no justification for a departure from orthodox economic criteria in establishing the regulatory framework for railroad rate making. In this section, I shall discuss the opposing

principles calling for rates based on "fully distributed costs" and on incremental cost floors. I shall show that the appropriate decision-making context is vital to the understanding of these principles. Confusion has arisen out of what is essentially a backward-looking, or auditing, conception of economic reality. Decisions, whether these are made by individuals, firms, or regulatory agencies, are necessarily forward looking, and it is always erroneous to base such decisions on past events that are irrevocable.

In a forward-looking context, all costs are incremental. The only costs that are relevant for rational decisions are those costs that *will be incurred as a result of taking the decision.* Costs that must be borne as a result of past commitments are not really economic costs at all. To attempt to call these costs, and to add these to the incremental costs that are predicted to occur in carrying out a decision, amounts to a distortion of the choice-making process by making the *costs of the decision* appear higher than is actually the case.

This is straightforward economic theory, but it is often overlooked, even by sophisticated theorists. The confusion here stems, at least in part, from the fact that, in ordinary conditions of business behavior, no conflict between incremental cost pricing and the recovery of full costs seems to arise. In the long run, the total revenues of business firms in competitive markets must cover the costs of their entire operations if they are to survive, and such firms are continually in the processes of making decisions of many kinds. In each decision, rational behavior involves a balancing off of incremental costs, *to be incurred after decision,* against incremental benefits, *to be enjoyed after decision.*

What results will behavior of this sort produce over the long term? Historically speaking, if each and every decision is informed by an accurate prediction of incremental costs and benefits, and if no decision is ever taken unless the benefits are expected to be in excess of costs, then it necessarily follows that, in total, revenues produced will be suffi-

cient to cover the total costs of the operation. Thus, in an idealized world in which firms all possess perfect information as to the future results of each decision made, including long-term investment decisions, incremental cost decisions would appear to produce results that would also be consistent with full cost decisions. But business firms do not make decisions in an idealized world where the future can be predicted with certainty; decisions must, in each case, be based on the best information that is then available to the firm, and errors in prediction must occur in a changing world. When error is allowed for, the results of incremental cost decisions may diverge sharply from those based on the use of fully distributed costs.

Hence, the basic confusion here stems from the proclivity to observe results that must emerge from the long-run adjustment process in the competitive economy, when all errors have been "ironed out," so to speak, and to infer that these results can be implemented directly, without the adjustment process taking place. Thus, it is inferred that pricing decisions based on fully-distributed costs provide the proper benchmark for regulatory activity, an inference that overlooks the adjustment process that must produce such a result. The making of decisions on the basis of an appropriate comparison of incremental costs and incremental benefits is, over the long term and allowing for full adjustment, perfectly compatible with the production of revenues sufficient to cover the total costs of the operation. By contrast, if an attempt is made to set prices, explicitly, so as to cover "full costs," in some backward-looking sense, this will, necessarily, tend to forestall the very adjustment process that is required to insure overall economic efficiency.

A simple analogue from economic theory may illustrate this point. We know that the rate of return on capital investment tends to be equalized in all investments. From this, however, we cannot infer that an imposed equalization of rates of return in various employments would produce desirable results. Obviously, the way in which rates of re-

turn tend to become equalized is through the flow of capital resources among the various industries, *in response to different rates.* Equalization among rates of return is a result of this process, not a norm.

There are features peculiar to railroad ratemaking, and its regulation, that make the distinction between incremental cost decisions and fully-distributed costs decisions especially important at the present time. The railroad structure that exists is the result of many past decisions, past commitments. It is an old industry, and it is known to embody a heavy capitalization in fixed plant, of a longlived variety. This essentially technological fact, plus the changing patterns of demand for transportation services, insures that fully-distributed costs for the railroads are necessarily high if these are measured in a backward-looking sense. But, as I have tried to show, the costs or outlays that must, in any case, be incurred as a result of *past* decisions are, or should be, wholly irrelevant for the making of forward-looking decisions, which are, of course, the only decision that can be made, *in the present.* The costs that are relevant to present decisions are those that must be incurred, incrementally, as a *result of taking a decision,* whether this be a decision on investment, on the inauguration of a new service, on a modification in a rate structure, or a decision of the Commission to allow some variance in existing rates.

All of this can, perhaps, be clarified by a homely example. Suppose that Jones has purchased a $6 ticket for next Saturday's football game, which entitles him to a seat on the 50-yard line. Suppose, also, that Brown has purchased a 50-cent ticket that entitles him to stand in the end zone. Saturday now arrives, and it is pouring rain. What considerations should Jones and Brown take into account in deciding whether or not to go to the game? Surely each man should try to balance off his changes of getting pneumonia (his incremental costs) against the benefits that he expects to enjoy from watching the rain-soaked game. Once they have got their tickets earlier in the week, the money outlay,

the money costs, paid for these tickets are irrevocably "sunk," and these should have no place in their decisions as to whether or not to go to the game. The mere fact that Jones has paid more for his ticket, as a result of a past decision, than has Brown should not suggest that Jones should, because of this higher "full cost," brave a greater chance of getting pneumonia.

In rate making, railroads seem often to be placed in the position of Jones in this example. Because they have, in the past, made decisions embodying a large total outlay than has been covered in receipts, it is argued that railroads should, in their forward-looking current decisions, set rates for predicted future operations so as to reflect these past commitments. This argument is no more sensible for the railroads than for Jones. To prevent the railroads from lowering rates to incremental cost levels because fully-distributed historic costs are not covered is analytically equivalent to forcing Jones to stand in the rain because he has previously bought a high-priced ticket. And Jones who stands in the rain when he should be at home by his fireplace, is analytically in the same position as the railroad company which, because it is forced to charge unduly high rates, watches traffic carried by other media which it could, effectively and profitably, move with its own equipment.

Section 4. **Cost Comparisons Among Competing Carriers.**

It is a commonly accepted principle of economic theory that prices will tend to be equalized among firms supplying essentially the same services. This result *emerges* out of the workings of the competitive process, however, and it does not imply that a directed or forced equalization of prices, before the adjustment process of competition has been allowed to work itself out, will be beneficial. This point is very similar to that which was made above with respect to full-cost pricing. In fact, a forced equalization of prices will prevent the very adjustment of custom among competing suppliers of services that is necessary to produce efficient transportation.

The argument to the effect that rail freight rates should be based somehow on the "costs of the low cost carrier" amounts to an application of essentially this sort of backward reasoning to the problems of rate making. If, in fact, regulation is efficient in allowing for the *emergence* of that pattern of traffic among competing media which incrementally oriented decision making would produce, incremental costs for the low-cost carrier will tend to be rate-determining, for all media. However, it is essentially reverse or perverted logic to argue that, because this result tends to emerge, steps should be taken to implement this result *directly* by setting rates on the lowest-cost carrier basis. To attempt this would surely prevent the very shifts in traffic flows which would, over time, guarantee the equivalence of incremental costs, among genuinely competing media. In point of fact, the only way in which competing media can be observed to be supplying similar services lies in the results that are allowed to emerge from the traffic adjustments to rates that are allowed to emerge from the traffic adjustments to rates that are related to incremental cost floors, appropriately measured. It is impossible for the external observer, be he specialist or layman, to determine what are *similar* transportation services, independently of the demand-adjustment process in response to varying rates. For such an observer to attempt to determine what are "similar" services, and to use such an impressionistic classification as a basis for rate differentials, requires an omniscience that few mortals possess. This is because "similarity" or "equivalence" in services, in economic terms, can only be defined rigorously with respect to the degree which ultimate users, consumers or buyers, are willing to *substitute* the services of one supplier for another. Any test of similarity requires, necessarily, observation of the degree to which buyers are willing to make such substitutions. And rate making on the basis of presumed similarity in service, grounded, perhaps, on a superficial resemblance, will tend to prevent the very adjustments that would allow user substitution to take place.

Section 5. **Summary and Conclusion**

By way of summary, there appears to be no basis in theoretical economic analysis for the imposition of floors on railroad freight rates that are above incremental costs, appropriately defined with respect to the operation of the railroad under consideration and over the time span that is relevant. If the objective of national transportation policy, and of rate regulation, is that of promoting overall efficiency in the economy, the primary efforts of regulatory agencies should be aimed at preventing unjust *increases* in rates by carriers, made possible by localized monopoly situations, and not in preventing decreases in rates, especially when such decreases do not bring rates below appropriate incremental cost levels. If localized monopoly positions exist, and the efforts of the regulatory agencies were directed toward these, the stated objectives of the national transportation policy would be served. The regulatory authorities should, in the course of carrying out this task, keep a watchful eye for genuinely predatory practices where and when they occur. But allegations of "predatory practice," "unfair competition" or "unjust discrimination" should not be allowed to become a cloak behind which the inefficient operations of various transportation firms are protected from the test of genuine, even if regulated, competition.

Exhibit No. 40

STATEMENT OF RICHARD B. HEFLEBOWER

My name is Richard B. Heflebower. Since 1949 I have been professor of economics at Northwestern University. Prior to the War, I held that rank at Washington State University and also was Dean of the School of Business Administration. From February 1943 to August 1946, I was with the Office of Price Administration and for most of that

period was an economic advisor to the Deputy Administrator for Price. From 1946 until joining the Northwestern University faculty, I was a member of the senior staff of the Brookings Institution in Washington, D.C. In the research that I carried on there and since, and in teaching graduate students, I have specialized on the problems of the structures and behavior of markets, especially price behavior. My publications have dealt chiefly with competition and prices. At various times I have been an economic consultant to industrial corporations and to government agencies and to the non-profit Committee for Economic Development.

With respect to the problem being examined in this hearing, economists have held quite uniformly to the same findings for decades. I refer to the well-worked out criteria of the optimal use of an economy's resources and of the corresponding economically-best prices of commodities and services. The relevant definitive parts of economic theory, or principles, have been clearly set forth in Professor Baumol's testimony. Several implications of these economic principles have been developed by Professor Buchanan. He has also shown how these principles contribute to optimal use of resources devoted to transportation and to the welfare of shippers and consumers.

I shall relate these principles specifically to certain features of the railroad industry, particularly those that explain why the optimal use—the socially most efficient use—of resources devoted to transportation does not require that each rate bear the same relation to the relevant costs. These costs, as economists agree, are the incremental costs.

1. The Relevant Time Period.

Economists' analysis of the relations among the relevant costs and demand on the one hand and prices or rates on the other hand involves the same general principles, no matter what the pertinent period of analysis. But the choice of cost (and sometimes of demand) to be included in the calculation does depend on the length of period or "run" involved in the problem.

The "length of run," that is, the length of time relevant for pricing decisions, is not given by any fixed span of calendar time—a certain number of months, years, or decades. Rather, the pertinent length of time depends on how long a waiting period is required before current commitments are terminated so that new decisions can be made about them. For example, decisions relating to a piece of equipment whose expected economic life is 20 years, involve a 20-year commitment (except insofar as part of its cost can be recovered by sale) and that is the relevant time period.

In accord with economic analysis, we may distinguish three such types of period, the short-run, the intermediate long-run and the long-run. The first of these, the "short-run" refers to a period shorter than the life of depreciable physical facilities and equipment. Except for extraordinary pricing decisions—for example those concerned with prices applicable only for a short period of time—the short-run is too brief for the relevant cost calculations. Ordinarily, prices which cover only such short-run incremental costs will not make the necessary contribution to the maintenance and replacement of depreciable equipment. Similarly, the very long-run is not the relevant period because in railroading many facilities are essentially permanent—they require maintenance but not replacement. Rather, it is the intermediate long-run costs which are pertinent since prices which cover intermediate long-run incremental costs provide the funds for replacement of all facilities which are not permanent and for which a continuing demand is anticipated. This "intermediate long-run" corresponds to what is meant by "long-run" in the last line of the main text of page 2 of "Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs."

2. **Excess Capacity in Railroading.**

There are several unusual characteristics of railroad cost structures which are important for their pricing decisions. As already indicated, a substantial proportion of the railroads' facilities are, for all practical purposes, permanent.

Moreover, these facilities are typically characterized by substantial excess capacity, an important fact related to rate policy as will presently be shown. Such excess capacity in these quite permanent basic facilities is usually a built-in inherent feature of railroading.

For a railroad to exist at all, it must have a large minimum capacity in line-haul way and structures and in some terminal facilities. Consequently, the economies of scale (potential effect of size of plant on cost per unit of service) are marked in railroad transport. It is true that its basic facility (line haul and terminal facilities) can vary widely in its qualities and, hence, in its capacities. But large scale basic facilities will often result in lower costs, even when used below capacity, than will low capacity facilities, particularly if weight is given to the lower quality of service which results from the use of the latter.

Usually, in order to give the quality of service that is optimal for shippers as a group, the quality of roadbed and bridges, and the weight of rails must be (and quite generally is) such as to permit fairly heavy trains to move at more than creeping speeds and to operate with minimal interruptions of service. Either because of such necessity or of an earlier optimistic forecast of traffic volume, railroads quite generally have excess capacity in line haul basic facilities. Excess capacity means that more trains could be operated over the tracks and the road's total cost (including capital and other costs related to permanent facilities) per train mile or per ton mile would decline without causing a significant decline in quality of service in terms of effect on shippers' (as a group) own operating costs.

An additional source of excess capacity of basic facilities is the "way and structures" quality and capacity required to provide these transport services in which railroads have a relative advantage. Heavy loads of bulk commodities are often of this sort. A well-built roadbed and heavy rails may minimize costs of such hauls even though once built they represent excess capacity.

Given this "built-in" excess capacity—primarily in the railroads' permanent facilities—additional traffic that provides incremental revenue above intermediate long-run incremental costs has two effects. It provides added operating revenue in excess of additional or incremental costs and, in a term frequently used, thereby makes "a contribution to burden." Second, the increased traffic enlarges social output from these fixed facilities; overall efficiency of resource use in transportation is enhanced thereby.

3. **Differences Between Rates and Incremental Costs.**

Where excess capacity such as that just portrayed is present—and, in fact, it prevails quite generally throughout the railroad industry—rates that beat variable relations to long-run incremental costs are economically preferable to rates for different transport services, each of which equals some estimate of total costs, including costs that are not variable in the intermediate long-run.

If railroads use intermediate long-run incremental costs as a rate floor, by inference many rates will be above the floor, and indeed, above fully-distributed—or some other measure—of total cost. But it can also be inferred that the rational guide to such higher rates (relative to long-run incremental costs) is the intensity of demand for the service in question and, more specifically, what economists call the elasticity of demand. It should be emphasized that what is relevant is not the elasticity of demand for transportation but for *transportation of the particular segment of the traffic in question by rail.* Consequently, the rational determination of the level of such a rate must rest on consideration of incremental cost *and of incremental revenue,* i.e., the effect of varying levels of the rates on the aggregate revenue derived by railroads from hauling that commodity.

It may be contended that such variations in railroad rates relative to their corresponding incremental cost floor constitute unfair treatment of these shippers who are charged higher relative rates. Such an inference is incorrect; the fact that the railroad can charge the higher rate and nevertheless

obtain the traffic must reflect either the superiority of the railroads' services or the unavailability of another form of transport with intermediate long-run incremental costs below these rail rates. Furthermore, to the extent that the railroads' incremental revenue from traffic obtained at lower rates (that are above the floor, of course) exceeds incremental cost, the effect is to lower the level of full costs per ton mile. ("Permanently" fixed costs are spread over a larger volume.) An incremental cost floor rate policy thereby permits the very rates that are alleged to be "unfair," in fact to be lower than they could be otherwise.

What has been shown here is that an intermediate long-run incremental cost floor with rates for various transport services varying upward from that floor, is necessary for the optimal use of resources in the railroad industry. It has been demonstrated also that rates for different services that bear different relationships to such an incremental cost floor do not treat some shippers unfairly. These conclusions are reached by use of established economic principles applied in a manner appropriate to the unique features of the railroad industry.

4. Relation to Other Transport Modes.

What remains is the consideration of the effect of such a rate policy on other transport industries and through that on a social policy for optimal use of resources in transportation.

Where the intermediate long-run incremental cost of another transport industry is above that of railroads (for service of equivalent quality) that other industry is not as economically efficient as the railroads. On the other hand, where the intermediate long-run incremental cost of any other transport mode is below that of railroads, it is more efficient.

Application of this principle requires some care. The costs of other transport industries that clearly measure their relative economic efficiency are their own long-run incremental

costs plus the *social* incremental costs of the publicly-owned facilities—including, for example, highways, waterways and airports—which they use in providing the service being priced. When proper account is taken of such social incremental costs, and it is established that the railroads' intermediate long-run incremental costs are lower than those of other carriers, the railroads are the more socially efficient transport mode, and vice versa. Protecting a carrier that is less efficient by this criterion against lower rates of the more efficient carrier creates a barrier against the efficient use of society's resources.

5. **Summary Comments: Inherent Advantage.**

Now the criterion for measuring the "inherent advantage" of a type of carrier becomes evident and provides the central theme for summarizing economists' interpretations of that term. Where cost is the only pertinent factor, a synonym for "inherent advantage" or "inherent disadvantage" of a type of carrier is the level of its intermediate long-run incremental costs compared to the incremental costs of other types of carriers. Rates of one type of carrier that are not below its intermediate long-run incremental costs cannot, therefore, injure another type of carrier which has a superior inherent advantage or, in the economists' language, a type of carrier that uses resources more efficiently. Only a type of carrier less efficient in use of resources can be injured by a rival's rates below the former's intermediate long-run incremental costs; and it is injured only because it is not socially efficient.

By no means does this test of social efficiency require that all types of carriers establish the same rates for a particular haul. There are differences in the quality of service various carriers are capable of rendering or do render. On the other hand, speed of delivery and other aspects of service are of differing value to various shippers. So long as no type of carrier charges less than the appropriate incremental cost, choice of carrier according to relative rates and related services should be left to the shippers, as Professor Buchanan points out.

Nor do rates have to be as low as the intermediate long-run costs, or have a uniform relation to those costs, in order to meet the criterion of optimal social usage of resources in transport. All problems of price determination involve demand as well as the relevant costs. Rates for different services necessarily reflect the elasticity of demand for the various services, or the extent to which higher or lower rates would affect the volume of a particular carrier. Consequently, a carrier can be expected to have some rates near incremental costs and others higher, even above some measure of total costs such as fully-distributed costs. Shippers paying the higher rates are those for whom there is not an alternative type of carrier able (because its incremental costs are lower) or willing to perform the service at a lower rate.

Rates that bear differing relations to incremental costs are particularly important for railroads because of the diverse conditions under which these carriers operate. They are the most general type of carrier for they serve nearly all parts of the country and haul almost every commodity in a wide variety of sizes of shipments and length of haul. The scope of the service offered by competing carriers of different modes is narrower in terms of their routes; the type of commodities carried; the length of their hauls; and, sometimes in the season of the year during which they operate. They select the combination of traffic characteristics for which their type of facilities and equipment is peculiarly adapted. But the test of their general efficiency in rendering this service is their intermediate long-run incremental cost. Only where these costs are below the intermediate long-run incremental costs of the railroads are they the more efficient carriers. A railroad rate floor which is based on intermediate long-run incremental cost will, therefore, provide ample protection for the inherent advantages of competing modes of transport.

Exhibit No. 38

I.C.C. Docket 8038
Witness: Ford K. Edwards
Exhibit _____

BEFORE THE
INTERSTATE COMMERCE COMMISSION
WASHINGTON, D.C.

INGOT MOLDS -
PENNSYLVANIA TO STEELTON, KENTUCKY
I.C.C. Docket 8038

Testimony of Ford K. Edwards

April 21, 1964

Exhibit No. 38

Q. 1. Will you please state your name and address.

A. Ford K. Edwards of Edwards & Peabody, Transportation Consultants, 1111 E Street, Washington 4, D.C.

Q. 2. Will you please state your education and experience.

A. I have a degree of Bachelor of Science in Electrical Engineering from Iowa State University (1925). I also have a Master of Arts degree in Economics with a Transportation major from Yale University (1927). I received my Ph.D in Economics from Yale University in 1933.

My experience embraces eight years in the operating and traffic departments of railroads, motor carriers and telephone utilities; four years as transpor-

tation economist and examiner with the California Public Utilities Commission; ten years as principal economist, head cost analyst and Director of the Bureau of Accounts and Cost Finding of the Interstate Commerce Commission; six years as Director, Department of Coal Economics, National Coal Association; and five years on the staff of the University of Southern California, College of Commerce and Business Administration, conducting courses in the general fields of economics and finance, as well as in the areas of rail and motor transportation, public utility regulation and traffic management. Since May 1, 1956, I have maintained offices as Transportation Consultant in Washington, D.C.

Q. 3. Have you done any writing in the area of transportation costs, rates and economic principles?

A. Yes. The studies and reports I have written or directed include Principles of Motor Transportation - McGraw Hill Company; A Study of Rail Cost Finding For Rate Making Purposes, California Public Utilities Commission, 1938; A Study of Rail Freight Service Costs in the Various Territories of the United States; U.S. Senate Document 63, 78th Congress, 1st Session; and an Interstate Commerce Commission study entitled "Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs"(1954).

Q. 4. Have you made an analysis of the levels and structure of railroad freight rates in the United States as they relate to the costs of performing the service?

A. Yes. I refer to the so-called burden studies of the Interstate Commerce Commission showing the levels of freight revenues by commodities and territories and their relationship to the out-of-pocket costs.

Q. 5. What do you consider to be the pertinent costs in this proceeding for rate-making purposes?

A. As is generally recognized, price determinations throughout the economy basically rest on the factors of supply and demand. The regulated industries are no exception. Pricing must reflect the economic incentives necessary to induce those who supply the goods and services to make the necessary financial commitments. Where a multitude of services are produced by a plant, many costs cannot be individually traced. These non-traceable costs include both fixed expenses which do not change in magnitude when the quantity of output varies, and joint costs which exist when the production of certain goods or services makes available directly related products or services. Rail back-hauls are illustrative.

As a result of these characteristics, long recognized by transportation economists and those engaged in transportation pricing, there is no fixed relationship between rail transportation costs and railroad rates. In my judgment, rail cost ascertainments serve but one primary function in pricing, i.e., to determine the out-of-pocket (incremental) costs of carriage. The expenses so determined set the floor below which particular rates and charges should not go. Total system expenses for all rail services performed, freight and passenger, including a return on capital employed, indicate total system revenue requirements.

As I have said, the levels of the individual rates assessed for the many services rendered by a railroad to its shippers are governed by the market factors of supply and demand to the same extent that market elements control pricing generally throughout the economy. Faced with these economic realities, the necessary aim of the railroads is to determine that margin above out-of-pocket costs at which a rate produces the maximum total contribution to fixed costs and net income, the volume of the traffic induced being a necessary consideration. Under

such approach, each shipment contributes in accordance with its ability to pay, or market capabilities. The volume of traffic and aggregate dollar contribution of the lower rated commodities to fixed costs are thereby maximized. At the same time the burden on the higher rated commodities with comparatively inelastic demand is less than that which would apply under any other system of pricing.

A most critical factor in pricing is that the "cost floor" be that which correctly reflects the out-of-pocket or added costs undertaken by the carrier in handling the shipment being priced. If rates are set too high, they may act to discourage traffic which, in fact, is profitable. Both as to concept and practical application this out-of-pocket cost "floor" should reflect, to the fullest extent possible, the actual additional costs undertaken in the handling of the traffic in issue. Such costs are commonly referred to by economists as the incremental or marginal costs.

Transportation economists and regulatory authorities, notably the Interstate Commerce Commission, have long recognized the "value-of-service" rate-making principles which are here involved. The Interstate Commerce Commission's annual studies on the "Distribution of the Rail Revenue Contribution by Commodity Groups" clearly demonstrates the universal application of such principles to rail rate-making under conditions of constant costs. This document, issued each year, identifies the tonnage, revenues, out-of-pocket costs and revenue contribution to burden of each commodity transported by the railroads. At Table 7 the profitability of each class of traffic for 1960 is measured by the dollars of contribution (above out-of-pocket costs) toward the constant costs and other overhead expense burdens. The Commission's statement for 1960 shows the

tonnage handled at rates which yielded less than the so-called fully distributed costs. Such tonnage amounted to 789 million tons out of the total rail carload tonnage handled in 1960 of 1,203 million tons. In short, 65 percent of the rail tonnage in 1960 moved at rates below the so-called fully distributed cost levels. The lack of any economic significance to fully distributed costs as a guide to rate determination is here clear.

For the reasons given above, the rail "out-of-pocket" or incremental costs have a critical significance in determining that level of the rate which will yield the maximum contribution to fixed costs and burden. Thus, if rates were set merely at the "out-of-pocket" cost level the revenues would but equal the added costs incurred to handle the traffic and no contribution to fixed costs or buden would be made. As the contribution per ton is the difference between the out-of-pocket costs per ton incurred in taking on the traffic and the revenue per ton received, the aggregate contribution of the traffic to constant costs and burden is maximized at that combination of rates and volume where the product of the number of the tons carried and the margin of the revenue per ton over "out-of-pocket" cost is the greatest.

These incremental costs, i.e., the added expenses or so-called out-of-pocket costs which are incurred as a result of the handling of the involved traffic constitute, in my opinion, the only costs of service data which are pertinent or significant to the economic determination of a rate.

Q. 6. To sum up, in your judgment what is the critical part played by cost of service determinations in fixing rates?

A. In my judgment the *sole* purpose of cost finding in fixing rates is to ascertain the cost floor or break-even point in handling the added business.

Q. 7. Would the rates or rate structures be set at this break-even point?

A. No, they would not. Rates will be set at various margins above this level depending upon the ability of the traffic to pay, i.e., on value-of-service considerations. Both in principle and practice the foregoing means the fixing of rates at such margins over incremental or out-of-pocket costs as will maximize the contributions to constant costs and other revenue requirements.

Q. 8. Is the incremental cost here a direct determinant of the rate itself?

A. No, it is only a part of the rate build-up. If the rate were constructed at the level of incremental costs, there obviously would be no contribution to the constant costs.

Q. 9. Is it important that the incremental costs accurately reflect, insofar as possible, the additional expenses which the traffic under study occasions?

A. I believe it to be important that the expenses reflect, insofar as reasonably attainable, the added costs of handling the involved traffic. If the costs here employed are erroneously high, or if they include constant costs or passenger deficits, they will have the effect of discouraging traffic which can be profitably transported.

Q. 10. Does the historic pattern of rail rates and charges conform to the rate-making basis you have here described?

A. Yes. Shortly after the Commission's freight traffic Waybill Studies were inaugurated the Cost Section of the Commission introduced its studies of the "Distribution of the Rail Revenue Contribution by Commodity Groups." The purpose of these studies was to indicate the compensativeness of the rail rates by commodities and territorial movements.

Q. 11. Do these Commission releases indicate the profitability or revenue contribution of each class of commodity carried?

A. Yes, the annual studies of the Commission make such a showing. These studies report not only the percentage relationships between the revenues and the out-of-pocket or incremental costs, but also the critically significant figure of total dollar contribution earned over and above the incremental costs.

Q. 12. Have you prepared a table showing relationships of revenues to out-of-pocket costs which illustrate the principles you speak of?

A. Yes, shown in the table to follow are the ratios of the revenues to the out-of-pocket costs for certain commodities and commodity groups. The out-of-pocket costs here referred to include, among other factors, an allowance for return on 100 percent of the equipment and 50 percent of the road property.

TABLE I

Revenue Contribution by Selected Commodity Classes and All Commodity Groups, 1960

U.S. to U.S.

Commodity and Code (1)		Ratio Revenue to Out-of-Pocket Costs (2)	Contribution Above Out-of-Pocket Costs (Millions) (3)
	Individual Commodities		
305	Bituminous Coal	110	88
309	Iron Ore	114	26
411	Lumber, Shingles, Lath	136	82
549	Plastics	190	12
553	Drugs, Toilet Prep.	155	2
597	Machinery Parts	249	12
685	Electrical Equipment	217	20
	Commodity Groups		
900	Products of Agriculture	119	167
910	Animals and Products	107	14
920	Products of Mines	109	152
930	Products of Forests	118	84
940	Mfrs. & Misc.	152	1,226
960	All Commodities	129	1,658

Source: I.C.C. Statement No. 2-62, May, 1962.

The illustration in Table 1 above demonstrates the fact that the margin of revenues above out-of-pocket cost is not the significant rate-making factor. Rather, the significant factor is the volume response of the traffic to the rates set and the resulting aggregate dollar contribution to burden.

Whereas the revenues on some commodities cover their out-of-pocket costs by very small margins, the volume of the movement indicue is of such magnitude as to make such traffic among the most profitable handled by the railroads.

Referring to Table 1 above, bituminous coal, Commodity Code 305, moves at rates averaging but 10 percent above out-of-pocket costs yet yields a contribution of $88 million, an amount exceeded by but very few commodities.

It is to be noted here that the relatively highrated Commodity 597, Machinery Parts, moves at rates 149 percent above out-of-pocket costs, but yields a contribution of but $12 million, far less than that of bituminous coal.

Q. 13. What conclusion do you draw from the foregoing?

A. I draw the conclusion that the making of rail freight rates on individual commodities is a function which has no direct relation to the costs of the service, except to assure that the rate covers incremental costs. The margin of the rate above the incremental cost floor is a value-of-service and not a cost consideration.

Q. 14. In your judgment, can any so-called full-cost figure serve an economic purpose in the fixing of railroad rates on the separate classes of traffic?

A. I cannot conceive of such a situation. There has been an instance where the Interstate Commerce Commission was interested in the comparative total costs of handling all rail traffic in the respective territories. I refer to Docket No. 28300, Class Rate Investigation.

The Cost Section of the Commission was there asked to make a showing of the relative total cost of rail transportation by rate territories as one of the considerations entering into the determination of the territorial-wide relationship of class rates one territory to another. Such cost data provide no basis for the fixing of any specific rate or charge. This observation is especially applicable to an agency of transportation with a high proportion of costs not capable of allocation except upon value-of-service considerations, and which transports a great range of unlike commodities with widely varying price characteristics, such as the railroad industry.

Q. 15. Do other transporation agencies have a pricing problem similar to that of the railroads?

A. In my opinion they do not. A railroad is unique in that before it turns a wheel or handles a ton of freight it must equip itself at the minimum with an extensive fixed plant consisting of land and right-of-way, road and terminal trackage, roadway structures and facilities, stations, and at least a minimum supply of freight cars and motive power equipment. It also must have a minimum organization to staff the railroad. All costs associated with this minimum plant represent constant costs. The investment is substantially fixed and the overwhelming part of the labor and material charges will be constant.

As volume increases, additional passing tracks, signalling, or eventually a second track, may be added but such physical expansion above minimum plant levels, in my opinion, would not be proportionate to the growth in traffic volume.

In short, I believe that railroads are unique in that they must create and maintain as a minimum a very substantial plant and staff organization as long as a

readiness to serve the public is maintained. Such readiness-to-serve costs are inherently of a constant character and in principle and fact must be set aside in treating with the variable costs. Also, as the traffic expands a more effective utilization of plant and staff is achieved. In short, an increase from one train daily to ten trains daily does not increase the total track structure and other plant facilities, and the staff of employees tenfold. Rail operating costs cannot, in my opinion, be considered as 100 percent variable with added traffic.

Q. 16. Do these considerations lend themselves to the employment of any full-cost concept as the floor to rail rates?

A. In my opinion, they do not. While the constant expenses are to be recovered, they are not recovered under any fixed pro rata ton or ton-mile basis, but rather through rates and charges which recognize the value-of-service considerations pertinent to the movement involved. This is an historic principle in the transportation and other fixed cost industries. Expenses which are of a joint or constant nature must be recovered on the basis of the relative ability of the users to pay. Such costs, indeed, cannot be traced to specific traffic movements on a cost-of-service basis. The response of the shipper to the rates set, commonly referred to as value-of-service considerations, is the critical factor.

Whether the rates applied are properly adjusted to that level above out-of-pocket costs as will maximize the contribution to overhead burden is a rate-making issue and not a cost consideration. The rate-making principles here involved were treated in connection with the showing in Table I above. In the fixing of rates consideration must be given to the ability of the traffic to move, and it is here that the historic factors of value-of-service enter into the pricing of

transportation. The carrier seeks that rate at which the margin earned over out-of-pocket costs, coupled with the volume induced by such rate, produces the greatest aggregate contribution to constant costs. This is a universal principle in pricing under conditions of fixed or joint costs.

Pricing in the railroad and utility fields, and throughout industry generally, where fixed or joint costs are involved, is guided by the universal principle of maximizing net income. Rates are set at the level at which the elasticity of demand, (i.e., reaction of the buyer in terms of quantities of service purchased), will bring the greatest dollar contribution toward the fixed costs and overhead burdens.

Q. 17. Has the staff of the Commission's Cost Finding Section expressed its views on this subject of pricing rail services under conditions of fixed costs?

A. Yes. The Interstate Commerce Commission's release of May, 1962, entitled "Distribution of the Rail Revenue Contribution by Commodity Groups" -- 1960 (Statement No. 2-62), prepared by the Cost Finding Section treats with the critical significance of the out-of-pocket costs to rate-making and the lack of any corresponding significance to the fully distributed costs. To quote:

> "The "fully distributed costs" in this study underlying Table 7 refer to the sum of the out-of-pocket costs and the statistical ton and ton-mile apportionment of constant costs computed as described above. The interpretation to be placed upon these fully distributed costs for rate-making purposes justifies some comment. Rates based solely on the fully distributed costs shown herein would not have the benefit of being guided by that prominent principle of rate making which involves the recognition of derived demand. This principle also is known as differential charging, produce discrim-

ination, or value-of-service pricing. Regardless of terminology, rates made without adherence to this principle will result in reductions on high-grade traffic and concomitant increases on low-grade volume traffic. Historically, rates reflect continuous interplay of economic forces so as to permit all commodities to move with the most reasonable freedom and at the same time contribute as much as possible to the transportation burden. Therefore, the ratios of revenue to out-of-pocket costs shown in Table 7, hereto have a rate-making significance which is not possessed by the "ratios of revenue to fully distributed costs shown in an adjoining column of the same table. Revision of rates to the basis of fully distributed costs would tend to cause volume traffic to move in smaller amounts with a consequent reduction in the contribution to burden which it now furnishes. Thereby an increase in rates rather than a reduction would be placed against the higher-rated traffic"
(Statement 2-62, p.2)

The lack of relationship between "fully distributed costs" and rate levels or rate structures is further indicated by the following Cost Finding statement:

"The term "revenue contribution," as used in this study, refers to the amount by which carload revenues resulting from the rate structure in effect during the year 1960 exceeded or failed to meet the out-of-pocket costs. The revenue contribution shown herein is a function of costs, rates, and volume, and reflects not only cost factors but also the influence of demand for transportation, a value-of-service factor which is independent of direct cost."
(Statement 2-62, p. 1)

Q. 18. Are the statements you have made hereinabove in response to previous questions in harmony with these

statements you have here quoted from the Commission Release 2-62?

A. In my opinion they are.

Q. 19. You have been discussing out-of-pocket expenses. Do the out-of-pocket expenses include an allowance for return on investment?

A. The Rail Form A cost procedures of the Commission provide for the inclusion in the out-of-pocket costs of an allowance for return on the rail plant property and also on car equipment, as the specific occasion requires.

Q. 20. What is your view as to whether it is appropriate in this instance to include a return on road property?

A. The inclusion of return on road property as an out-of-pocket cost depends on whether the instant traffic here involved may be expected to contribute to the expansion of the carrier's plant. It is my understanding that the carriers involved have ample track capacity and, in the past, have carried greater tonnage than they are now able to attract. Under such conditions I do not believe that the incremental costs computed for the involved movement of ingot molds should contemplate expansion of the road plant facilities. In such case the allowance for a return on the roadway facilities should not be considered as a part of the incremental costs in this proceeding. The effect is to reduce the out-of-pocket costs by some 9 or 10 percent.

Q. 21. The employment of incremental costs as a floor has long been a factor in the construction of rail rates that reflect value of service considerations and permit the traffic to move. I here refer to the I.C.C. statement 2-62 showing the Rail Revenue contribution by Commodity Groups. Does the presence of water competition nullify these rate-making principles?

A. In my opinion it does not. The assumption is made by a witness for the Waterways Freight Bureau that under inter-agency competitive situations a railroad should abandon its normal rate-making principles and disregard its own cost characteristics. In short, the rail rates would not be based on the out-of-pocket costs as a floor with such allowance above this level as the value-of-service and market conditions would permit. Rather, the costs would embrace one or other statistical allocations of constant or fixed costs and passenger and LCL deficits. Rates based on costs as thus arbitrarily constructed would operate to exclude the railroads from participation in the involved traffic.

Considerations of the economic capabilities of the railroads to profitably haul traffic at various margins over incremental costs would thus give way to artificial and irrelevant rate-making standards. To sum up, when rail rates are not competitive with water carriers, let us say, the fixed costs of the rails are recognized as a burden to be recovered under rates which will permit the traffic to move. In short, rail rates are set at such levels above incremental costs, all economic factors considered, as will make the maximum contribution toward the fixed costs and burden. On the other hand, if the rates are found to be competitive with a barge carrier, then according to the latter, all normal rail rate-making principles would be set aside and some form of arbitrary, statistical full-cost, ton-mile distributions applied.

The reasons for these contradictory positions may rest on a failure to appreciate the basic economic distinction between rail and waterway cost characteristics. In the briefest terms, it is noted that the rails supply their own roadway plant and facilities all of which would continue irrespective of the instant traffic.

In contrast, government supplies the corresponding rights of way for water carriers. The fixed costs for waterway improvements are borned by the government. No taxes are assessed water carriers for the use of waterways. Water carrier costs approach 100 percent variability.

The railroads have a substantial body of constant costs or burdens, much of which is traceable to fixed plant costs. These costs will exist whether or not the instant traffic is handled. The rail rate-making problem is necessarily that of setting rates which are sufficiently competitive under each set of circumstances to move the traffic and yield a contribution to fixed costs and burden. Making arbitrary, statistical allocations of total system cost requirements is believed to be without meaning in approaching rate-making. The only answer to these rate-making problems is to determine the floor to costs and to add thereto such additional margin as the value-of-service and competitive factors permit. Any other approach would deny the rail carrier of the right to participate in the haul of the traffic in issue.

Q. 22. You have referred to the problem of overstating rail costs in rail-water competitive cases. Would an overstatement of the "break even" or incremental costs be detrimental to the rails?

A. Yes, it could lead to the railroads foregoing traffic which they could, in fact, handle profitably. A reference to Table I hereinabove indicates that for all commodities handled by rail in the United States the margin over out-of-pocket or incremental costs is about 29 percent. A very large volume of rail traffic obviously moves at rates exceeding out-of-pocket costs by small margins. The employment of proper cost concepts, as well as accuracy in determining the incremental costs is essential.

I have explained earlier the circumstances and limited purpose for which fully-distributed costs were initially created, i.e., in resolving broad class rate issues relating to the comparative costs as between major rate territories of the United States (Docket 28300). The employment of fully distributed cost figures in individual rate proceedings would, in my opinion, be somewhat analagous to adding up the prices on the sales tickets for all items of merchandise displayed in a department store and dividing the total by the aggregate tonnage of the merchandise. The resulting average price per ton conceivably might serve some uncertain purpose in comparing the quantity and quality of the goods carried by competing department stores, but it certainly serves no useful purpose in arriving at the appropriate selling price of a particular item of merchandise. Yet I believe this is analagous to injecting territorial average constant costs and return and total regionaal passenger and LCL deficits into the statistical determination of a rate on ingot molds between Neville Island, Pa. and Steelton, Kentucky.

Q. 23 Are you familiar with the testimony of Dr. Baumol, Dr. Buchanan and Dr. Heflebower with regard to the fundamental principles underlying the pricing of railroad freight services?

A. I have read the testimony of these witnesses and I am in full accord therewith. As I interpret Dr. Baumol's testimony the only cost data pertinent to the fixing of a rate is the so-called incremental or additional cost incurred in taking on the specific traffic which is under consideration. A knowledge of these added costs that will be incurred is important for the elementary reason that one does not want to construct a rate that fails to cover the additional costs to be met in handling new business. Certainly, this sets the lower limit of the rate.

Having thus established the floor to the rate at the level of incremental costs one is through with cost-finding insofar as the fixing of the rate is concerned. From this point on, the rate-maker is faced with considerations as to the remaining revenue needs of the railroad.

These revenue needs in the aggregate include the constant or fixed operating expenses of the rail plant. Under the Cost Finding Section's procedures 20 percent of all operating expenses, rents and taxes are treated as constant. There are also in this category allowances for a return on investment for 50 percent of the roadway plant which is treated as a fixed cost. The passenger and LCL deficits are also to be recovered.

The ability of the various classes of freight traffic to contribute toward these general revenue requirements varies greatly as between commodities. The territorial percentage relationships of revenues to out-of-pocket costs by commodity classes and territorial movements range up to 250% or more. Such variations reflect the value-of-service or demand conditions unique to each movemend and each territory.

Q. 24. What interpretation do you draw from these Commission studies which show wide variations in the relationship of revenues to costs?

A. These studies clearly support the economist's view that the only purpose served by costs in rate-making is to establish the incremental cost floor to rates. Beyond this point the rate-maker is guided by the necessity of recovering from each article transported whatever contribution it is capable of making toward total revenue requirements, each market situation considered.

Q. 25. Can this revenue contribution be determined by simply dividing the carrier's total constant and fixed

costs by the total tons or ton miles of traffic handled and adding this statistically derived amount to the incremental costs?

A. My answer is No. It would be rare indeed that such a result would reflect the "ability-to-pay" of the study traffic. Such a procedure would drive away from the railroad great quantities of the low-grade or lower rated traffic such as coal. It would also drive away any higher grade traffic upon which rail rates have had to be reduced to meet the competition of for-hire highway carriers or water carriers or shipper-owned transportation facilities.

On the other hand, much of the contributions now made to the fixed cost burdens by the higher grade traffic now moving freely under the existing rates would be lost. In fact, I do not see how the railroad industry could survive under a system whereby all revenue requirements over and above the incremental or out-of-pocket costs were given some arbitrary statistical prorate over all the tonnage.

Q. 26. What do you visualize would be the effect on the railroad industry under a full application of the fully-distributed cost concept, i.e., the constant and fixed costs and passenger deficits distributed for pricing purposes on some arbitrary ton or ton-mile basis.

A. As I have previously noted, some 65 percent of the total tonnage of the railroads in the United States moves at rates yielding less than fully distributed costs. The application of some version of the "fully distributed" cost concept as a floor to all rail rates would no doubt require rail rate increases of a far-reaching nature. Such increase would be required in spite of the fact that rail rates applicable to every commodity group have been trending sharply downward over the last decade. I here cite the ratio (percent) of the United States carload revenues to out-of-pocket costs for the years 1952, 1956 and 1960.

Ratio (percent) - Carload Revenues to Out-of-Pocket Costs

Commodity Group	1952	1956	1960
Products of Agriculture	137	126	119
Animals and Products	121	112	107
Products of Mines	125	121	109
Products of Forests	132	127	118
Manufactures & Misc.	185	173	152
Forwarded	156	132	119
Total	152	142	129

Source: I.C.C. Statement No. 2-62, Table 3, p. 11

As the above data indicate, the margin of the rates over out-of-pocket costs have been declining sharply for every commodity group.

These figures demonstrate the impact on rail rates of increased competition from other modes of transportation. Between 1951 and 1961 rail freight traffic declined substantially from 655 billion revenue ton-miles to 570 billion. On the other hand, intercity freight traffic by motor vehicle, public and private rose from 188 billion to 305 billion ton-miles. Inland waterways ton miles, including the Great Lakes, rose from 182 billion to 210 billion.[1] The entire growth in the nation's intercity transportation in the last decade has gone to agencies other than the railroads.

In my opinion the application of any program to substitute some fully distributed cost concept for incre-

[1] Interstate Commerce Commission Intercity Ton Miles 1939-1959 Statement No. 6103, I.C.C. Annual Report (1962), p. 12.

mental costs as a floor to railroad rates would result in a heavy diversion of freight traffic to other transportation agencies. Each successive loss of the lower rated rail freight traffic to other agencies of transportation would narrow the traffic volume from which the constant and fixed costs must be recovered with corresponding upward pressure on the rates of the remaining traffic. Such a rate program, in my opinion could lead only to successive losses of traffic with the railroads eventually pricing themselves out of the market.

Q. 27. What is the basic distinction between barge transportation and rail transportation which would permit a water carrier to orient its rates heavily with direct costs, whereas rail rates have historically given consideration to both cost and value-of-service (or demand) considerations?

A. A. primary factor is the difference in cost characteristics. In the case of transportation agencies which do not furnish or maintain their own roadway plant, the expenses vary closely with the volume of traffic handled. In short, the added costs incurred in handling added traffic closely approach total costs.

In contrast, railway transportation is characterized by a large fixed plant with its attendant fixed charges and taxes. Rail transportation is also characterized by a large body of constant or fixed operating expenses or burdens, including the passenger and LCL deficits. The distribution of these burdens to the traffic must rest on the value-of-service or market considerations. To take these fixed costs and burdens and statistically distribute them prorate over the traffic without regard to the effect of the rates so constructed on the movement of the traffic is quite meaningless in my judgment.

Q. 29. Are you familiar with the results of the cost studies made in this proceeding by Mr. Javoronok, Cost Analyst of the Pennsylvania Railroad, and Mr. Charles Bowman, Cost Analyst of the L&N?

A. I am familiar with the findings in these studies, which deal with the costs of ingot molds between Neville Island, Pennsylvania and Steelton, Kentucky. Employing Pennsylvania Railroad and Louisville and Nashville costs, respectively, for each carrier's portion of the haul, an out-of-pocket cost of $4.69 per ton was developed following Rail Form A. procedures. This compares with the proposed rate of $5.11.

Q. 30. Based on these relationships between costs and revenues, are the carriers justified in applying the rate adjustments sought?

A. I believe they are fully justified in their proposed rate action if the added revenues generated exceeds the added costs incurred, a condition which the results of the cost studies show to be met.

The proposed rate of $5.11 exceeds the out-of-pocket costs by 9 percent. In my judgment the inclusion of return on the roadway investment improperly exaggerates the showing of out-of-pocket costs, the roadway plant investment not being affected by the addition of the traffic in question. Excluding road return as an element of out-of-pocket cost, the added cost is $4.27. The proposed rate of $5.11 exceeds this out-of-pocket cost, excluding road return, by 20 percent.

Q. 31. Witness Steiner states at page 4 of his statement that no carrier or group of carriers could operate for very long under a rate structure which merely approximates marginal (out-of-pocket) costs. What is your view on this matter?

A. My view is that a railroad carrier should seek to haul all traffic the revenues from which exceed the incremental cost of carriage. Any other attitude by man-

agement would, in my opinion, be irrational. In this instance the rates exceed the marginal costs by margins that compare closely with those experienced in major traffic groups. (See Table 1, p. 10 hereinabove.)

Railroad revenues and the contributions to constant costs and burdens in particular, are derived from traffic a significant portion of which moves at narrow margins over out-of-pocket costs. It would be irrational for a railroad to overlook the potential contribution to fixed costs and burden which any movement of traffic can generate through appropriate rate adjustments.

Q. 32. Witness Steiner computed so-called "Rail Full Costs" inclusive of total operating expenses, return and recovery of passenger and less-carload accounting deficits. What, in your opinion, is the significance of such cost approach?

A. As I have previously indicated, I believe arbitrary statistical distributions of constant or fixed costs have no economic significance in fixing rail prices. In the transportation market as well as in other markets the price must be set at that level above incremental costs, which will both move the goods and yield the maximum contribution toward constant costs and overhead burdens. This is a matter to be resolved only by market determinations and proper judgment to be exercised in each instance.

Q. 33. In summary, what do you consider to be sound pricing policy for rail transportation?

A. In my opinion, it is essential that the pricing policy for railroads should recognize the cost characteristics peculiar to the railroad industry, namely, the presence of both variable and fixed costs. The function of costs is limited to the determination of a cost floor reflecting the incremental expenses. Considerations of the value of the service or elasticity of demand

will basically determine the margin above such floor at which rates should be established. The fully allocated costs in my opinion serve no purpose in the rail rate-making process.

Exhibit No. 41

I. & S. Docket 8
Witness: Finley
Exhibit No. 41

STATEMENT OF JOHN D. FINLEY

My name is John D. Finley. My service in The Pennsylvania Railroad Company Traffic or Sales Departments dates from 1929, and over 25 years of this period have been spent in Freight Rate work. I have been Assistant General Manager-Freight Rates since 1955.

During the 35 years since 1929, there has been an almost complete change in the pattern of rail traffic. When I first started in rate work, competition with other forms of transportation was slight, almost non-existent except in the limited areas where barge, alke or coastwise steamer operations or pipelines existed. The criteria of rate making then employed by the railroads were totally different from those of today. In that period, with the absence of competition, primary emphasis was laid on the usual classification principles for fixing rate levels, such as value of the commodity. Where the I.C.C. or state commissions had prescribed maximum rate levels on certain heavy moving commodities, both in bulk and in other than bulk, these were also in fact minimum rates on which the volume of traffic moved, as there was no effective competition.

In contrast, today in no area of railroad traffice is there any "captive" business. Competition in one or more of many forms has penetrated the full range of rail traffic. There seems to be the misconception that certain kinds of

freight must move by rail at rates which are not influenced by competition. To whatever extent this may have been the case in past years, it most definitely is no longer true. Competition is not limited only to other forms of transportation—truck, water or pipeline. It is manifested in economic pressures which may be in the form of substitute materials available at lower laid down cost; or it may be in the form of forcing transfer of plants to be near new sources with lower transportation cost; or it may lead to decentralization of industry in a program to reduce transportation as a controllable cost. In virtually all rate proposals today, excluding those involving technical tariff problems relating to the provisons of the Tariff Circular or Sections of the Act, one or more of these competitive influences will be found.

Island to that point in a plant-to-plant movement.

There is a regular movement of these commodities from Neville Island, Pa., to Steelton, Ky. in lots of 600 gross tons, which are transported via barge from origin to Owensboro, Ky., and there transferred to trucks for handling to the plant at Steelton. Except for an occasional single car of urgently needed molds, this traffic is now moving exclusively by barge to Owensboro on basis of a total cost of 511 cents per gross ton, arrived at as follows:

	Rates and Charges in Cents Per Ton 2,240 Pounds
Barge handling to Owensboro, Ky. (By Mississippi Barge Line)	332 (Min.Wt. 600 tons of 2,240 pounds)
Transfer from barge to truck (By Owensboro River-Rail Terminal)	95
Truck handling Owensboro to Steelton (By Parr Trucking Service, Inc.)	84
Total	511

Authority For Barge Rate - Mississippi Valley Barge Line Co. Frt. Tariff 25-I, ICC 110.

Authority For Truck Charge - Charge of $15.00 per hour, which averages 84 cents per ton of 2,240 pounds, based on the tonnage handled and time consumed in such handling.

The present rail rate on this traffic is 1059 cents per 2,000 pounds (or 1186 cents per 2,240 pounds) as shown in Exhibit (2), and the shipper definitely advised that unless an all-rail rate is established which equals the cost to the shipper of 511 cents per 2,240 pounds when movement is via barge-truck, the rail lines will not participate in the movement of this traffic.

Steelton, Ky. is a local station on the L. & N. RR. and the Green River Steel Corporation plant at that location has a private siding. In

EXHIBIT 3

by the Owensboro River-Rail Terminal Company at Owensboro, Kentucky. Transfer from barge to truck at the docks is made by crane operated by the Owensboro River-Rail Terminal Company. Delivery at Steelton is by for-hire truck.

The charge for unloading from barge at Owensboro by the Owensboro River-Rail Terminal into trucks is 85 cents per net ton. The charge for the movement by commercial truck from the River Terminal at Owensboro to the steel company's plant at Steelton is $15.00 per hour per truck, which averages 84 cents per gross ton based on the tonnage shipped and trucking charges assessed. This is seen from exhibits filed with the protest, being reproductions of a freight bill of the Mississippi Valley Barge Line covering a shipment of June 29, 1963, weighing 1,463,730 pounds and a shipment of March 30, 1963, weighing 1,397,780 pounds, and letters from Owensboro River-Rail Terminal and Parr Trucking Service, Inc.

This traffic normally moves exclusively by barge in connection with truck delivery. In isolated instances production schedules have required a rush order of single carloads which have been routed by railroad. If the railroads are to participate substantially in the movement, it will be necessary to have a rate not exceeding the total costs to the Green River Steel Corporation of the present method of handling. The proposed rate will enable the rail carriers to do so. This, of course, contemplates normal common carrier service by rail. If the proposed rate is approved and becomes effective, this company will allow the railroads to share in this business. It would be our purpose to use the short line route of the Pittsburgh, Chartiers & Youghiogheny—

Pennsylvania Railroad to Cincinnati and the Louisville and Nashville Railroad to destination.

VERIFICATION

I solemnly declare that I have examined the foregoing statement and that the representations contained therein are true.

Joe C. Westerfield

EXHIBIT 13

American Commercial Barge Line Co., at the time the protest was filed had reported it had not handled any of this particular traffic. It was requested to check this matter for inclusion in my later Exhibit 16 through the year 1963. It was physically unable to do so because recent flooding on the Ohio River at its Jeffersonville, Ind: office where its records are kept caused a temporary closing of that office and removal of personnel to a Louisville location. Its records are not available to it at this time.

Exhibit 15 shows the consist of traffic handled by all the Bureau members in the year 1962 based on individual reports to the Bureau. The assembly of these statistics is explained on the reverse side of the Exhibit. It will be noted that Iron and Steel, which includes Class 579 in which the carriers report ingot molds for statistical purposes, was the third most important commodity grouping available to barge service, accounting for 10.81% of their total 1962 revenues. Also to be noted is the fact that the barge carriers depend upon 11 commodity groupings for 81.45% of their total 1962 traffic revenues.

Exhibit 16 is a statement showing the total tons of ingot molds transported by the members of Waterways Freight Bureau, by years, for the last 11 years, from Neville Island, Pa. to Owensboro, Ky.

During my service with a single barge line or as Chairman of the Bureau, having contact with actual or prospective shippers, I have never encountered a situation in which a shipper has not insisted upon a showing that he would save money by using barge service, as the predicate for a rate. And when I refer to a money saving, I mean that the overall or ancillary costs attached to the use of barge service must be lower than those attached to the rail service entailed in the same undertaking. Even in cases where shippers discount the greater value of rail service and assure the Commission they will "divide" the traffic both rail and barge at a parity of rates, it does not work out that way. For example, in *Iron or Steel Slabs from Cincinnati to Riverdale*, 308 ICC 151 (July 20, 1959), a case involving these same barge lines, the Commission observed from that record that the total barge transportation charges asserted by the shipper were $7.13 per ton (pg. 152). The protested all-rail rate in that case was $7.13 per ton. The shipper witness there testified, as recounted at page 152-153 of the ICC report:

> "This witness further testified that time in transit by barge approximates 18 days, in comparison to 9 days by rail, and as ample storage facilities are available at origin and destination, neither the 500-ton barge minimum nor the extra time in transit is of importance. The controlling factor in the selection of a transportation agency, according to this witness, is costs, and unless costs are qualized by rail, he has no alternative but to route the traffic by the cheapest mode available, which as shown, is by barge. However, if the proposed rate is permitted to become effective, he has promised a 50-50 apportionment between rail and barge."

In permitting the rail rate in the "Slabs" case which matched the total barge charges, the ICC made a finding (page 155):

> " . . . that at equal rates both will receive an equal portion of the traffic."

"Both" referring to 1), the rail lines and 2), the barge lines. Exhibit 17 shows the barge movement of slabs, by years, from Cincinnati-Newport to Riverdale, before the parity of rates was permitted, and after. Our information is that the movement still exists. Obviously the rails have it all. Exhibit 17 shows that there has been no movement by barge since 1962.

Ordinarily, the shippers who use barge service are the larger industries capable of handling traffic in large consignments of 300 tons, or more. Almost invariably these shippers as well as their receivers have private or individual sidings. If they also have barge docking facilities at each end of the haul, the comparison between the costs to the shipper of all-rail service and barge service is relatively simple. On the rail side, the cars are spotted at the shippers siding where he loads the freight into the car. At the destination end the shipper unloads the car which is spotted on his private siding. On the barge side, the published rate ordinarily, and in the instant case, applies only from in barge at origin to in barge at destination. The shipper must load the barge at origin at his expense and the consignee must unload at his expense. In that situation, the true comparison is between the all-rail rate, as such, and the barge rate plus the difference, if any, in the cost of loading and unloading, rail cars versus barge.

In situations where industry tracks at origin or destination, or both, are situated away from the water carrier's dock, the shipper in figuring overall costs to him, will add to the barge rate the costs incident to switching or trucking to and/or from the barge dock, in determining whether he will save money. If the origin or destination, or both, make a line haul necessary beyond the port, the line haul cost for rail or truck service must be added to the barge rate.

Thus far I have referred to differences in transportation charges which affect the shipper and which can be accurately pinpointed. There are other differences which are of an im-

ponderable nature but which shippers take into account in choosing between competitive routes. In the instant case, for example, the rail movement will be in 12-car lots involving a single bill of lading and a single loading receipt. At destination only one plant unloading receipt will be necessary. The barge movement, by way of contrast, requires a barge dispatch, an unloading of the barge away from the plant, and a trucking operation requiring multiple trips, receipts, etc. While these things cannot perhaps be measured in arithmetic precision, they are factors which, in our experience, are constantly called to our attention as differences in transportation conditions which must be reflected in the barge rate. The barge rate is the only factor of the total charges over which the barge carriers have control.

Also, of course, is the matter of relative transit time. As other witnesses will show, in detail, the transit time involved in barge service is much longer than for rail service, a factor which also influences the shipper in his choice of routes. Other witnesses will deal with such operating details.

EXHIBIT 18

STATEMENT OF M. C. PEARSON IN I.&S. DOCKET 8038, INGOT MOLDS TO STEELTON, KY.

My name is M. C. Pearson. I am employed by the Mississippi Valley Barge Line as their Traffic Manager-Rates, at 411 North 7th Street, St. Louis, Missouri 63101. My employment with this company commenced in the Traffic Department on December 1, 1931, and I have held my present position since July 1, 1940.

The Mississippi Valley Barge Line is certificated under Docket No. W-78, as amended, issued by the Interstate Commerce Commission, to serve practically the entire Mis-

sissippi River Waterway System, including the Ohio, Allegheny and Monongahela Rivers. The shipper's dock at Neville Island is 7.1 miles below Pittsburgh, Pa., on the Ohio River and Owensboro, Kentucky is 756.5 miles below Pittsburgh on the Ohio River. We operate a regular service on the Ohio River and its tributaries and participate in the barge movement of Ingots and Ingot Molds from Neville Island to Owensboro.

My duties as Traffic Manager-Rates include the negotiation of rates with shippers and receivers, and the publication and maintenance of rates which are filed with the Interstate Commerce Commission. In my many years of experience in making rates for my company, I have found that our primary competition is the railroads, and that in order to compete with them we must be able to demonstrate to our customers that they will realize some savings in using the barge route, because the comparatively inferior and slower service of the barge route is attractive only if offset by an accompanying saving in transportation costs. We have never, to the best of my knowledge, been able to secure or retain traffic when the total over-all charges when compared with all-rail did not result in substantial savings. Some of the factors that shippers raise as their justification for demanding a saving via the barge route are:

1. Adequate storage space at origin plant to accumulate tonnage to meet bargeload minimum requirements.
2. Investment involved in maintaining such facilities and a large inventory.
3. Extra handling of the article shipped generally accompanying a movement as compared with rail.
4. Risk of loss and damage resulting from these additional handlings.
5. Proximity of rail sidings to plant normally require no extra movement of cars, whereas a switch movement is generally required to a barge loading facility.

6. Transit time via barge route is much longer than via rail with a consequently higher inventory expense.
7. Adequate storage space at destination plant to receive bargeload lots at one time.
8. The cost of maintaining such storage space and large inventories.
9. Lack of flexibility generally accompanying use of barge route, such as dove-tailing origin plant and destination plant operation for the maximum efficiency.

Exhibit 19 hereto is a copy of Fifth Amended Certificate in Docket W-78, which shows the complete operating authority of the Mississippi Valley Barge Line Company.

Exhibit 20 hereto is a chronology of bargeload rates of the Mississippi Valley Barge line on Ingot Molds and Ingot Mold Stools from Neville Island, Pa., to Owensboro, Ky. (Steelton) commencing with January 1, 1953. Except for some minor differences in effective dates, the rates of the other common carrier barge lines are the same.

Exhibit 21 hereto is a statement showing the over-all charges via the barge route on Ingot Molds and Ingot Mold Stools from Neville Island, Pa., to Steelton (Owensboro), Ky., together with the proposed rail rate of $5.11 per gross ton.

The Mississippi Valley Barge Line has participated in the movement of Ingot Molds and Ingot Mold Stools from Neville Island, Pa., to Owensboro, Ky., since the inception of the Green River Steel Corporation plant at Steelton in 1953. While this movement might not be considered substantial when compared with other movements in which we participate, it is nevertheless an important one to us and its loss would be hurtful. This is a port to port movement and is the type on which we must rely for our bread and butter if we are going to survive as a common carrier by water.

I have made a study of our movements of Ingot Molds and Ingot Mold Stools for the years 1962 and 1963 and

find that the average transit time for moving barges from Neville Island to Owensboro was approximately 8 days. This does not include the time for loading the barges; the lay time at origin awaiting pickup by our towboat; and the time consumed in unloading at Owensboro.

There is no question in my opinion, based on past experience, that if the proposed rail rate of $5.11 per gross ton is allowed to become effective, our route would not be used for this movement at the present level of rates. To reduce the barge rate to a level that would continue to make the slower barge route attractive would require us to establish a rate substantially below our fully distributed cost. This, we believe, we should not be forced to do, particularly when the barge route is the low-cost route when fully distributed costs of barge vs. rail are compared.

I have read the statement of Mr. Joe C. Westerfield, General Traffic Manager of the shipper that:

> If the proposed rate is approved and becomes effective, this company will allow the railroads to share in this business.

From my experience the railroad "share" will be 100 per cent. I make this statement for two reasons: First, this particular shipper was using barge service on another commodity on which he incurred overall costs below those incident to all-rail service. We have not had this movement since the rail lines reduced their rate to a level below the overall charges via barge effective October 22, 1963. I cannot, therefore, conceive of him using barge service on a parity of rates in this particular instance. Secondly, we have had instances in which shippers on the witness stand have asserted that they would divide traffic between barge routes and rail routes on a parity of costs. One particular instance comes vividly to mind.

In Fourth Section No. 34540 Iron or Steel Slabs from Cincinnati, Ohio and Newport, Kentucky to Riverdale, Ill., reported at 308 I.C.C. 15, authority was granted rail lines

to establish and maintain a rate of $7.13 per ton of 2,240 pounds for the transportation of Slabs, Iron or Steel, unfinished, in carloads, minimum 100,000 pounds from Cincinnati, Ohio and Newport, Kentucky to Riverdale, Ill., and to maintain higher rates from and to intermediate points. The report in this proceeding will show that the rate of $7.13 per ton of 2,240 pounds equalized the overall charges via barge and at pages 152-153, 308 I.C.C. the following statement is made:

> "The controlling factor in the selection of a transportion agency, according to the witness, is costs, and unless costs are equalized by rail, he has no alternative but to route the traffic by the cheapest mode available, which as shown, is by barge. However, if the proposed rate is permitted to become effective, he has promised a 50-50 apportionment between rail and barge."

The rail rate of $7.13 became effective on August 28, 1959. We had no movement via our line after that date in 1959; no movement in 1960; a small movement in May and June of 1961; and a movement in the months of January, March, April and May of 1962. We have had no movement since that time, despite the fact that we published a reduced rate of $5.00 per ton of 2,240 pounds from Cincinnati, Ohio and Newport, Ky., to Chicago (Riverdale), Ill., effective January 1, 1964. Using the incidental costs at origin and destinations shown at page 152 of 308 I.C.C., the overall costs via barge under the new rate would aggregate $5.78 per ton of 2,240 pounds as compared with the present rail rate of $7.24 per ton of 2,240 pounds published in C.T.R. Tariff 434-E, I.C.C. No. 3388.

A division of traffic under a parity of costs is simply not in the cards.

I have had an opportunity to read the statement of Robert M. Tyrie on behalf of Union Barge Line and what he says as to the physical aspects of barge transportation and equipment applies equally to our line.

EXHIBIT 20

CHRONOLOGY OF BARGELOAD RATES ON INGOT MOLDS AND INGOT MOLD STOOLS FROM NEVILLE ISLAND, PA., TO OWENSBORO, KY., COMMENCING WITH JANUARY 1, 1953.

Date	*Rate per Gross Ton*	*Minimum Weight (Gross Tons)*
January 1, 1953	$2.84	500
March 23, 1955	2.70	500
December 1, 1955	2.70	500
May 1, 1956	2.86	500
March 15, 1957	3.00	500
November 6, 1957	3.12	500
July 1, 1959	3.12	600
November 1, 1960	3.32	600
January 1964	3.32	600

Tariff Authorities:

M.V.B.L. 25-B, I.C.C. 97
M.V.B.L. 25-C, I.C.C. 101
M.V.B.L. 25-D, I.C.C. 103
M.V.B.L. 25-E, I.C.C. 104
M.V.B.L. 25-F, I.C.C. 107
M.V.B.L. 25-G, I.C.C. 108
M.V.B.L. 25-H, I.C.C. 109
M.V.B.L. 25-I, I.C.C. 110

EXHIBIT 21

STATEMENT SHOWING OVER-ALL CHARGES VIA THE BARGE ROUTE AND THE PROPOSED RAIL RATE ON INGOT MOLDS AND INGOT MOLD STOOLS FROM NEVILLE ISLAND, PA. TO STEELTON (OWENSBORO), KENTUCKY.

	Rate or Charge (Per Gross ton)
Barge line-haul rate–Min. Wt. 600 G.T.	$3.32 (1)
Transfer from Barge to Truck at Owensboro	.952 (2)
Trucking to Plant of Green River Steel Company	.85 (3)
Total	$5.122
Proposed Rail Rate	$5.11

(1) Tariff Authority: ACBL I.C.C. No. 9, MVBL I.C.C. No. 110, ORC I.C.C. No. 15, UBL I.C.C. No. 22.

(2) Owensboro River-Rail Terminal rate of 85 cents per net ton converted to a gross ton basis.

(3) Parr Trucking Service, Inc., average per gross ton based on actual charges made for trucking two bargeloads of Ingot Mold and Stools in March and June 1963.

EXHIBIT 22

Statement of J. Paul Toner

* * *

I cannot recall any instances in which our company was able to participate in any business on a parity of rates, which would include accessorial rates, in competition with all-rail rates from and to the same customers. In this respect our experience is the same as that described by Mr. Pearson and Mr. Tyrie.

EXHIBIT 25

Statement of Robert M. Tyrie

* * *

Marked for identification as my Exhibit 30 is a statement showing the chronological history of railroad carload rates on Ingot Molds from Neville Island, Pa. to Steelton, Ky. This exhibit clearly demonstrates that the rate was reduced from $14.93 per gross ton to $11.18 per gross ton on September 5, 1958. Another reduction from $11.28 per gross ton to $10.59 per gross ton was made effective February 10, 1963.

Another statement, marked for identification as my Exhibit 31 is a statement showing the railroad carload rates on Ingot Molds from representative origins to representative destinations. This statement shows the Docket 28300 miles and the percent that the rail rates are of the First Class rates. With the exception of the water competitive rate from Neville Island, Pa. to St. Louis, Mo., and from Pittsburgh, Pa. to Chicago, Ill., the rail rates range from 17.5 percent to 27.0 percent of First Class. The present rate from Neville Island, Pa. to Steelton, Ky. is 16.1 percent of First Class and the rate under suspension is only 6.9 percent of First Class.

Iron and steel articles represent one of the most important commodities handled by Union Barge Line Corporation. As our Annual Report for the year 1962 to the Interstate Commerce Commission (Form K-A) will reveal, these commodities represented about 24 percent of our total tonnage and about 43 percent of our total revenue. For that reason, I am vitally concerned with any downward adjustment in the freight rates on iron and steel articles by competitive modes of transportation.

As a general proposition, I know that barge lines cannot expect to handle traffic when the overall charges via the barge route are at or near a parity with the charges via the rail route and certainly barge lines cannot compete when

rail rates are lower than the overall charges by the barge route. In other words, unless we are able to demonstrate a savings in freight charges to the shipper, he will not use our services. Even on a parity of charges the barge line is at a disadvantage because of its inferior service. Operating against us in these situations are such factors as our heavier minimum weight requirements, our less frequent sailings, our slower transit time and our unanticipated delays resulting from fog, ice and high or low water conditions, to say nothing of the added expense and inconvenience of multiple handling over the barge route. Other factors which the shipper takes into consideration in the choice of modes include, among other things, such items as increased interest on investment on the larger volume shipment and increased interest on investment resulting from the slower transit time. These are known factors which shippers take into account whenever they have to make the determination of whether a shipment will be moved via the barge or rail routes. Whenever a study is made of the charges via the barge route, the shipper also takes into consideration the excess cost of loading barges versus rail cars and the charges for moving the shipment to and from the barge loading and unloading ports.

As I indicated earlier, if the overall charges by the barge route are not less than the charges via all rail, the shipment will be routed all rail because there is no advantage to the shipper in routing his shipment by the more expensive barge route.

I will admit that there are isolated instances where shippers will divide their shipments between barge and rail when the overall charges are on a parity but, in all of my experience, I know of not a single ingot mold that has moved by barge when the overall charges were the same as, or more than, the charges by rail between the same points. Except where the shipper has a most peculiar marketing or production problem, giving rise to some latent advantage, Union Barge Line Corporation cannot expect to participate in the movement of any commodity by barge unless our overall

charges are differentially lower than the charges by rail. As I have said, such is a most remote possibility in the movement of ingot molds.

In cases where the railroads have reduced their rates to eliminate that differential, we have lost the traffic completely to the railroads. Examples of such loss of traffic are: Pipe Coating Material from Neville Island, Pa. to Louisville, Kentucky; Sugar from New Orleans, Louisiana to Evansville, Indiana; Scrap Iron from Chicago, Illinois to Weirton, West Virginia; Sugar from New Orleans, Louisiana to Pittsburgh, Pa.; Tinplate from Pittsburgh, Pa. to Tampa, Florida; and I could continue to cite examples ad nauseum.

Under no circumstances is a shipper willing to pay us a premium for our service and the amount of the differential that is required to permit the barge lines to compete effectively will vary from one shipper to another and from one commodity to another depending always, of course, upon the traffic management policies of the involved shipper.

Exhibit No. 30

I&S Docket No. 8038
Exhibit No. (E) 30
Witness: Robert M. Tyrie

STATEMENT SHOWING CHRONOLOGICAL HISTORY OF CARLOAD RATES ON INGOT MOLDS FROM NEVILLE ISLAND, PENNSYLVANIA, TO STEELTON AND OWENSBORO, KENTUCKY

Rates in dollars per net ton, except as noted

	Basic Rate	Increased Rate	Authorized Increase	Minimum Weight
*April 15, 1954	$ 10.49	$ 12.06	15% X-175-B	50,000 lbs.
December 20, 1955	10.49	12.06	15% X-175-C	50,000 lbs.
March 7, 1956	12.06	12.78	6% X-196-A	50,000 lbs.
December 28, 1956	12.78	13.42	5% X-206	50,000 lbs.
August 26, 1957	12.78	13.93	9% X-206-A	50,000 lbs.
February 15, 1958	13.93	14.93	$1.00 NT X212	50,000 lbs.
September 5, 1958	10.18	11.18	$1.00 NT X212	100,000 lbs.
October 24, 1960	11.18	11.28	$ .10 NT X223	100,000 lbs.
February 10, 1963	10.59	10.59	---	100,000 lbs.
November 15, 1963	10.59	10.59	---	100,000 lbs.
	5.11[1]	5.11[1]		112,000 lbs.[2]

[1] Rates in dollars per gross ton.

[2] Applies only when shipped under one bill of lading from one consignor at one origin to one consignee at one location at one destination in one day, subject to an aggregate minimum weight of 600 tons of 2,240 pounds, each car to be loaded to a minimum weight of 112,000 pounds.

* Prior to April 15, 1954, commodity took class rates, i.e., class 32½ or 44 cents per 100 pounds subject to general increases as made effective subsequently, such as X-148, X-162, etc.

TARIFF AUTHORITIES:

TLTTB E/S 145-D	ICC A-968
TLTTB E/S 145-E	ICC A-1079
TL-CTRTB E/S 738	ICC C-334

Exhibit No. 32

STATEMENT OF DELBERT M. STEINER

My name is Delbert M. Steiner. I am a transportation economist specializing in the analysis of cost, traffic, and statistical data. I received a Bachelor of Science in Commerce in 1940 from the College of Commerce of the University of Iowa and the degree of Master of Arts in 1959 from American University in the fields of economic theory and transportation economics.

I have been engaged in the analysis of transportation cost, traffic, statistical, and other economic data for the past twenty-two years. For the last five years, as a private transportation consultant, I have appeared before this Commission and state regulatory agencies on behalf of various railroads, motor carriers, water carriers and users of transportation services. During the preceding five years, I was employed by the Post Office Department as senior postal rate economist, responsible for the review and analysis of parcel post rates and services, and for preparation of recommendations for reformation of rates and conditions of mailability of fourth-class mail matter. Between 1950 and 1954, I was employed in the Office of the Secretary of Defense as Chief of Statistical Analysis and Economic Evaluation for the Military Traffic Service, and was responsible for the direction of statistical and economic programs concerning the transportation of both persons and mat[illegible]. I was employed as a transportation cost analyst w[illegible] the Cost Finding Section of this Commission from 1946 to 1950. It was during these years that the general form of many of the motor carrier and railway cost formulae and studies were developed.

I also served as a full-time consultant to the Transportation Task Force of the Commission for the Reorganization of the Executive Branch of Government, more commonly called the Second Hoover Commission.

I

The Waterways Freight Bureau has asked me to review the cost data introduced by the rail cost witness and from them determine the Rail Full Cost of moving ingot molds from Neville Island, Pennsylvania, to Steelton, Kentucky. ton, Kentucky.

The out-of-pocket cost data as developed by the rail cost witnesses has been accepted by me in Part II of this statement for the limited purpose of determining the Rail Full Cost using their operating factors and cost adjustments.

My serious reservations in limited accepteance of these cost data is discussed in Part III of my statement. My use of the out-of-pocket cost developed by rail cost witnesses should not be construed as accepting them as any reasonable approximation of the rail cost of moving ingot molds traffic between Neville Island and Steelton.

II

The railroads propose to establish a rate of 511 cents per gross ton (2,240 pounds) for the movement of ingot molds from Neville Island, Pa., to Steelton, Ky., applicable on a minimum movement of 600 gross tons in not less than 12 rail cars. Although the railroads intend to apply this rate over a number of routes, they have introduced the out-of-pocket cost for this movement over only the short-line route, i.e. PC&Y (Duffs Jct.) PRR (Cincinnati) L&N. The distance for this short-line route is 531 miles. (PC&Y, 7 miles; PRR, 304 miles; and L&N, 220 miles). Other practical routes would be from 21 miles to 74 miles more distant and would generally involve a greater number of interchanges.

Out-of-pocket costs for movement of ingot mold traffic over this short-line route were prepared by two rail witnesses. Witness Javoronok prepared the out-of-pocket costs covering the movement from origin to the Cincinnati interchange, and Witness Bowman from the Cincinnati interchange to destination.

Each witness prepared an estimate of the out-of-pocket cost using territorial level costs for the year 1961 and a second estimate using a Rail Form A application to their own companies for the year 1962.

For the purpose of discussion we shall use the costs as prepared by the rail witnesses, but with serious reservations as to whether they properly reflect out-of-pocket costs actually incurred in handling ingot mold traffic.

Out-of-pocket costs prepared by the two rail cost witnesses are shown in the following table.

Table 1

Movement	Out-of-Pocket Cost per Gross Ton	
	Territorial 1961	Individual Carrier 1962
(1)	(2)	(3)
1. Neville Island - Cincinnati	338¢	331¢ *
2. Cincinnati - Steelton	145¢	138¢
3. Total	483¢	469¢

* Movement on PC&Y Ry. at Eastern District Cost for 1961

The proposed rate of 511 cents exceeds the 1961 territoral out-of-pocket costs prepared by the rail cost witnesses by 28 cents or less than 6 percent. The proposed rate exceeds the 1962 individual carrier out-of-pocket costs as prepared by the rail cost witness by 42 cents, less than 9 percent. The data submitted by the rail cost witness would tend to indicate that the cost levels as a whole for the individual carriers do not differ significantly from the territorial levels of cost. The difference between the two methods used is less than 3 percent.

Both rail cost witnesses limited their preparation of cost data to the out-of-pocket level of cost and to the short-line route. No consideration was given to other elements of cost.

Neither rail cost witness drew any conclusions as to whether the extremely narrow margin between the proposed rate and out-of-pocket cost was an adequate contribution to rail constant cost for either carload traffic generally, for ingot mold traffic as a whole, for traffic moving between Pittsburgh and Owensboro areas, or, for the specific traffic here under investigation.

It is obvious that no carrier or group of carriers could operate for very long under a rate structure that merely approximates marginal (out-of-pocket) cost. Such a rate structure would not be substainable over a period of time, unless the marginal costs were the equivalent of full costs. The rail out-of-pocket costs which have been introduced by the rail cost witnesses are based upon 80 percent of operating expenses, rents and taxes; and 4 percent return on investment in equipment but on 50 percent of road investment.

There are at least four basic methods for determining Rail Full Cost, giving consideration to all costs which must be fully recovered by the railroad if they are to continuously provide transportation service.

(1) *Distribution of Rail Constant Costs on Basis of Service Units*

Recovery of 20 percent of operating expenses, rents and taxes and a 4 percent return on the remaining 50 percent of road investment represents the constant cost or transportation burden to be recovered by the railroads. In addition, rates on lcl and passenger traffic fail to recover the full cost allocated to those services. The extent to which railroads are fully recovering these constant costs from a given movement of traffic can be determined by comparing the margin between the rate and out-of-pocket cost for such a movement with the ton and ton-mile distribution of these constant costs as provided in Rail Form A. Rail Form A is the cost formula used by the rail cost witnesses in preparing the out-of-pocket costs.

The ton and ton-mile distribution of the rail constant cost as provided in Rail Form A for Eastern District and South-

ern Region for the year 1961 are developed in my Exhibit No. 33 (DMS-1) for ingot mold traffic under investigation.

Table 2

Description	Rail Territorial Cost 1961		
	East	South	Total
(1)	(2)	(3)	(4)
1. Rail Out-of-Pocket Costs	338.3 ¢	145.2 ¢	483.5 ¢
2. Rail Constant Cost *	177.4 ¢	98.5 ¢	275.9 ¢
3. Rail Fully Distributed Cost	515.7 ¢	243.7 ¢	759.4 ¢

* Rail Form A Distribution on ton and ton-mile basis.

There are numerous alternative ways in which rail constant costs may be distributed upon the basis of service units to determine a Rail Form A oriented "fully distributed" cost. Among these are:

(a) Car and car-mile basis similar to the Rail Form A ton and ton-mile basis.

(b) Number of carloads originated and terminated.

(c) Number of loaded car-miles.

(d) Number of loaded and empty car-miles.

(e) Number of tons originated and terminated.

(f) Number of net ton-miles.

(g) Constant Costs as a percentage of out-of-pocket cost separately for line haul and terminal.

(h) Constant Costs as a percentage to out-of-pocket cost without regard to line haul and terminal.

These allocations of constant costs are compared in the following table. Column (5) is an index with Rail Form A ton and ton-mile distribution of constant cost equalling 100.

Table 3

Method of Apportionment	Constant Costs Per Gross Ton			
	East	South	Total	Index
	(cents)	(cents)	(cents)	(percent)
(1)	(2)	(3)	(4)	(5)
Rail Form A	177.4	98.5	275.9	100
(a)	109.6	68.2	177.8	64
(b)	97.5	71.5	169.0	61
(c)	119.3	66.4	185.7	67
(d)	126.3	76.4	202.7	73
(e)	120.3	82.8	203.1	74
(f)	191.8	104.7	296.5	107
(g)	134.3	67.6	201.9	73
(h)	131.8	63.5	195.3	71

The lowest "fully distributed" cost of these Rail Form A oriented bases for the distribution of constant costs would result from use of a carload basis. This would produce a "fully distributed" cost of 652.5 cents per gross ton as compared with a revenue of 511 cents.

(2) *Distribution of Rail Constant Cost on basis of Revenue Need*

Rail constant cost may be computed as the revenue needed above Rail Form A out-of-pocket cost to fully recover the current volume of carload revenues. This average "carload revenue need" for the year 1961 is computed for Eastern District and Southern Region in my Exhibit No. 34.

Rail Full Cost for the movement of ingot molds can be determined by increasing the out-of-pocket costs as developed by the rail cost witnesses by the carload revenue need, the ratios shown on line 7 of my Exhibit No. 34 (DMS-2).

Table 4

	Rail Full Cost per gross to -cents-		
	Out-of-Pocket	Revenue Need	Total
(1)	(2)	(3)	(4)
Movement in Eastern District	338.3	1.209	409.0
Movement in Southern Region	145.2	1.433	208.1
Total Movement	483.5	-	617.1

Revenue contribution, the amount by which a rate exceeds out-of-pocket cost, may be compared with the distribution of constant cost to determine the relative revenue contribution. In table 5 the rail revenue contribution from proposed rate is compared with the distribution of rail constant costs.

Table 5

Description	Cents per gross ton
(1)	(2)
1. Proposed Rate	511.0
2. Territorial Out-of-Pocket Cost	483.5
3. Revenue Contribution	27.5
Constant Cost Distribution	
4. - Rail Form A - ton and ton-mile	275.9
5. - Rail Form A - carloads	169.0
6. - Revenue need	133.6

Revenue contribution of the proposed rate, 27.5 cents, would be about 10 percent of the conventional ton and ton-mile distribution of constant costs; 16 percent of the carload distribution; and 21 percent of the average current revenue need.

(3) *Average Total Cost including Return on Investment and Operating Deficits*

Rail Full Cost is also average total cost. It may be determined directly without first computing out-of-pocket cost and allocating constant cost on the basis of out-of-pocket costs (even though the results may be similar). Average total cost consists of operating expenses, rents and taxes, 4 percent return on investment (after federal income taxes), and accounting deficits from operation of rail passenger and less-carload services.

Average total cost is long term marginal (variable) cost in the true classical economic sense. This is a realistic economic framework within which to determine low cost carriage, the most economic allocation of national resources

directly purchased and used by each of the competing modes of transportation. This economic level of cost is particularly appropriate where the modes of transportation have significantly different cost structures. Holding any cost fixed in economic analysis assumes that prior investment in national resources must be protected. The consequence of such an economic policy would be to perpetuate that carrier which has made the greatest prior investment in national resources without regard to the most economic utilization of resources.

Rail Full Costs have been prepared using average total cost (Total operating expenses, return and recovery of passenger and less-carload accounting deficits) allocated to the Rail Form A, Schedule G Expense Groups. Witness Javoronok's 1961 Eastern District costs have been restated on this basis as have the 1961 Southern Region costs introduced by Witness Bowman. The average total costs for the movement of ingot molds from Neville Island to Steelton, using the methods and operating factors employed by the rail cost witnesses are:

Table 6.

Movement	Average Total Cost per Gross Ton
(1)	(2)
Within Eastern District	475.0 cents
Within Southern Region	212.9 cents
Total Movement	687.9 cents

The detail for these costs are shown in my Exhibit No. 35. The accounting deficits from passenger and less-carload service have been treated as an overhead expense.

Witness Rozaitis determined the average total barge cost including a 4 percent return on investment (after Federal Income Taxes) of 339.7 cents per gross ton. To this amount has been added 180 cents per gross ton as the consignee's

switching and handling costs. Thus, the average total barge cost of 519.7 cents per gross ton is directly comparable to the average total rail cost of 687.9 cents per gross ton.

(4) *Average Total Cost including Average Revenue Need*

Rail Full Cost must include provisions for recovering operating costs as well as the cost of capital dedicated to the production of transportation services. The cost of capital may be included either as a return on investment, as in (3) above, or as an average revenue need. The fourth method consists of substituting the average revenue need for the return on investment to reflect the cost of capital.

Average revenue need has been computed as the ratio of Freight Operating Revenue to Freight Operating Expenses, Rents and Taxes (excluding Federal Income Taxes). My Exhibit No. 36 (DMS-4) develops this ratio for the Eastern District and Southern Region for each of the three years 1960-62 and for the average of the three years. It also develops this ratio for the Pennsylvania Railroad and the Louisville and Nashville Railroad for the same periods. It should be noted that the ratios for the individual roads do not differ significantly from the territorial ratios for the region and districts to which they are assigned.

Average total operating cost for the ingot mold movement within Eastern District, based upon operating expenses, rents and taxes (excluding Federal Income Taxes) would be 355.8 cents per gross ton. This total operating cost increased to permit the recovery of Eastern District revenue need (7.0 percent) would be 380.7 cents per gross ton.

Average total operating cost for the ingot mold movement within Southern Region, based upon operating expenses, rents and taxes (excluding Federal Income Taxes) would be 148.4 cents per gross ton (using the method and operating factors of Witness Bowman). This average total operating cost increased to permit the recovery of the Southern Region revenue need (23.7 percent) would be 183.6 cents per gross ton.

The lowest sustainable Rail Full Cost, average total operating cost increased to reflect average revenue need, would be 364.3 cents per gross ton for the movement of ingot mold traffic. Barge Full Cost determined on this same basis, as introduced by Witness Rozaitis, was 355.5 cents per gross ton plus the additional consignee cost of 180 cents per gross ton, a total Full Cost by Barge of 535.5 cents.

III

Comments of Out-of-Pocket Costs Prepared by Rail Cost Witnesses

The out-of-pocket costs for the movement within Eastern District, Neville Island origin to the Cincinnati interchange are based upon: (1) average territorial factors for territorial costs, and, (2) system factors for the individual carrier cost for the Pennsylvania Railroad. Witness Javoronok does not indicate the system factors used in preparing the individual carrier costs. (Weights of train, empty return ratio of gondola cars, or switching minutes or cost).

Three comments are warranted from the cost data and statement submitted by Witness Javronok. Two relate to train weight factors and Group III (Remaining Running) cost, while the third concerns the consideration of switching at Pittsburgh.

First, Witness Javronok states that the use of Eastern District way train costs tend to overstate the line haul movement costs of the PC&Y, because the train weight of this Class II carrier would be increased to about 1700 ton including the competitive ingot mold traffic. The use of the heavier weight of way train, were it properly applicable, would have reduced the costs per carload by less than 15 cents or less than one-third of a cent per gross ton.

Second, Witness Javoronok used through train costs for movements in Trains PMC-3 (Pitcairn Yard Pittsburgh to Columbus) and Train CIN-1 (Columbus to Cincinnati). The use of through train costs would be justified only if the actual train characteristics approximate the through train, i.e.

Eastern District average weight of through train was 3,698 tons. The train weight and the other characteristics of the two trains were not introduced. The understatement from the use of through train costs could be many times the difference Witness Javoronok chose to call to the Commission's attention.

Third, Witness Javoronok fails to include any cost for the movement of the traffic between the interchange at Duffs Junction and start of the road train movement from Pitcairn Yard.

The out-of-pocket costs for the portion of the movement within Southern Region, Cincinnati interchange to the Green River Steel Plant spur at Steelton, Ky., were based upon: (1) territorial costs adjusted to reflect specific operating factors, and (2) Louisville and Nashville Railroad costs applied to these specific operating factors. The use of specific operating factors not based on special studies drastically reduce the costs for this segment of the movement without adequate factual support.

First, Witness Bowman's use of through train cost is not warranted from the description of the train movements between Cincinnati and Louisville (Train No. 75) and between Louisville and Owensboro (Train No. 158). Witness Bowman does not support his use of through train cost by introducing the average weight or consist of these trains. Witness Kirchner does not identify them as through trains, but does clearly indicate that these train crews perform a considerable amount of train switching at Louisville and between Louisville and Owensboro.

Second, Witness Bowman substantially reduced switching costs without adequate supporting data. Terminal road train to industry switching was reduced 78 percent, inter-intra-train switching was reduced 60 percent, and interchange switching was reduced 44 percent. The information furnished Witness Bowman by Witness Kirchner was neither consistent with, nor comparable to, switching factors developed by Rail Form A. It is highly improper to modify Rail Form

A unit costs and operating factors by broadly quantified judgment information. The testimony of Witness Westerfield indicates that empties moving eastbound are picked up by a westbound freight and carried to Doyle Yard. Such switching is not reflected by Witness Bowman. Further, Witness Bowman has included terminal freight car costs (Group VI) for only the loaded switching movement at destination (Bowman Exhibit, line 21), no car costs are included for an empty switching move.

Third, Witness Bowman has failed to include all of the terminal costs for destination (Group VIII costs have been omitted).

The out-of-pocket cost data prepared by the rail cost witnesses represent the lowest level of cost. The cost for movement in Eastern District represents the shortest route, while the cost for the movement, both switching and line haul, for Southern Region is grossly understated. For example, Witness Bowman reduced the out-of-pocket switching costs by 32.5 cents per gross ton based solely upon a possible operation described by an operating witness.

The rail out-of-pocket cost restated to correct for this unwarranted adjustment in switching costs would be 516 cents per gross ton, or 5 cents more than the proposed rate.

PROCEEDINGS

[5]

* * *

Mr. Ames: Mr. Examiner, there is a preliminary matter that I think we might settle at this time.

The parties have stipulated that the over-all costs for the barge-truck route are $5.11 per ton, which is exactly the same as the proposed rail rate. Mr. Leigh has stipulated that with me.

Mr. Leigh: I understand, Mr. Ames, that actually we were stipulating the truck expense from the transfer point at Owensboro out to Steelton. I have no objection to a stipulation such as you suggest, but my understanding is that the over-all cost is $5.15 instead of $5.11.

Mr. Ames: I think you are right. The barge rates are published and the only charges that could be uncertain are the transportation charge at Owensboro from barge-truck and [6] the trucking charge from Owensboro to Steelton. But there is an understanding that truck charges set forth in the protest are correct.

Exam. Dishman: Will you stipulate to that?

Mr. Leigh: Yes, sir.

Mr. Helmetag: Yes, sir.

* * *

[14] Q. (By Mr. Leigh) Would you please state your name and address? A. Joe C. Westerfield, 222 Brown Court, Owensboro, Kentucky.

Q. Mr. Westerfield, have you heretofore prepared for offering in this case and exchanged with Protestants a statement of facts? A. Yes, sir.

Mr. Leigh: Mr. Examiner, may we have the statement of Joe C. Westerfield marked for identification?

[15] Exam. Dishman: Respondent's Exhibit No. 3.

(Respondent's Exhibit No. 3, Witness Westerfield, was marked for identification.)

Mr. Leigh: Appended to Exhibit No. 3 is a diagram of the plant of the steel company presently marked Exhibit A. May we have that remarked?

Exam. Dishman: Respondent's Exhibit No. 4.

Respondent's Exhibit No. 4, Witness Westerfield, was marked for identification.)

Mr. Leigh: The next attachment is a photograph of the plant of the Green River Steel Company. May we have that marked?

Exam. Dishman: That will be Respondent's Exhibit No. 5.

(Respondent's Exhibit No. 5, Witness Westerfield, was marked for identification.)

By Mr. Leigh:

Q. Mr. Westerfield, since preparing your statement marked Exhibit No. 3, have you had an opportunity to make some closer investigation into whether you had any movement of ingot molds from Neville Island to your plant at Steelton by rail? A. Yes.

Q. And what was the result of your investigation? A. Do you mean what moved by rail?

Q. That is correct. A. I went back to 1962, and we showed two cars in 1962, and [16] 5 in 1963, and two cars as of March 26, 1964.

Exam. Dishman: At this point shouldn't there be a few changes in Exhibit No. 3?

Mr. Leigh: Yes, Mr. Examiner, I overlooked that. If we will look at page 2 of Exhibit No. 3 near the bottom of the page, there will be found references to Exhibits A and B, and the one exhibit A should be marked Exhibit No. 4, and where it shows Exhibit B should be Exhibit No. 5.

By Mr. Leigh:

Q. Mr. Westerfield, you make reference to the individual carloads taken during 1962, 1963 and 1964. Would you give us the weight of the lading in those single cars? A. These aren't accurate figures, they are in net tons, like two cars together. 112 net tons in 1962.

Mr. Ames: In each car?

The Witness: No, sir; that is the total of the two cars.

Mr. Helmetag: How much is it?

The Witness: 112 net tons.

By Mr. Leigh:

Q. Let's get it clear. On March 21, 1962 you had a shipment delivered to you in two rail cars, is that correct? A. That is true.

Q. And the total net weight was— A. 112 net tons.

Q. Now, would you proceed to give us the weights, the weight of the lading in the other single cars, and if they are not [17] single cars, indicate it. A. On January 30, 1963, one car, 60 net tons. February 14th, 2 cars, the combined weight, 106 net tons. April 22nd, 1 car, 63 net tons. On April 16th, 1 car, 47 net tons.

Q. Those were 1963? A. 1963. 1964, February 19th, we had one car, 67 net tons. On March 26th, one car, 49 tons.

Q. Mr. Westerfield, could you tell us what were the occasions for routing this by rail, these cars you have just mentioned? A. The occasion that brought this about occurs when you have a need for a different type mold than you already have, and you don't have time to wait for a combined barge or a big bunch of ingot molds. So if you are making a certain grade of steel, or a certain type, you would use a certain kind of ingot mold. And these were special orders for the occasion.

Q. Mr. Westerfield, you were furnished a copy of the testimony of Mr. Wesley Rogers to be presented here later by the Protestants. And included there was a tabulation showing the net tons of ingot mold moved by Waterways Freight Bureau members from Neville Island, Pennsylvania to Owesnboro, Kentucky. Did you check those tonnage figures provided by Mr. Rogers? A. I checked 1964, 1963, 1962, 1961 and 1960 barge shipments.

Q. Now, the figures you developed differed somewhat, did they not, from Mr. Rogers? A. Yes, sir; my figures show more tonnage shipped than Mr. Rogers.

Q. Would you just tell us the total for 1960 as you developed it? A. 1960, three barges, 1712 net tons.

Q. The same figure for 1961. A. Six barges, 3,878 net tons.

Q. And the figure for 1962. A. Six barges, 4,320 net tons.

Q. And for 1963? A. Seven barges, 5,017 net tons.

Q. And through March of 1964. A. Two barges, 1500 net tons.

Q. These are all net tons? A. Net tons.

Q. What has been your loss and damage experience, Mr. Westerfield, in the shipment of ingot molds? A. There has been no loss or damage occurred, no claims have ever been filed by us.

Q. Could you offer any explanation as to why that is so? A. Well, ingot molds are as a rule shipped in open-type barges or rail cars, they are stored outside, and there is very little damage that can come to them.

Q. Have you had occasion to observe the switching of railcars into [19] your plant? A. Yes, sir.

Q. Can you give the Commission an idea of the time, approximately, necessary for getting these cars off the L&N main line onto your siding? A. I would say it would take as an average 15 to 20 minutes to set off a cut of cars onto the siding that we have that is shown in Exhibit No. 4.

Q. Now, there has been no movement, has there, under these rates, obviously? A. No.

Q. But you have had occasion to observe multiple car cuts being set off at your plant, is that correct? A. It is very common to see 18 or 20 cars at one time of scrap iron and other material that we get.

Q. And you have personally observed these movements? A. Yes, sir.

Mr. Leigh: Mr. Examiner, the witness is now tendered for cross-examination.

CROSS-EXAMINATION

By Mr. Ames:

Q. Do you have the names of the barge lines which handled these shipments which you have read into the record? A. Yes, sir.

Q. Would you name them, please? A. 1960, two barges by the Ohio River Company, one by Mississippi [20] Valley.

1961, two by the Union Barge Line, two by the Mississippi Valley, one by the Ohio River Company, and there is a CB-303 barge, I believe that is Mississippi Valley, that would be another one for Mississippi Valley.

In 1962, Ohio River, two barges; the Union Barge Line two; Mississippi Valley, two.

1963, 5 Mississippi Valley Barge Line, one Union Barge Line, one Ohio River Company.

In 1964, one by Mississippi Valley Barge Line; one by Union Barge Line.

Q. When you receive a cut of 12 cars at your plant such as those you say you personally observed, are you able to take those cars into your plant all at one time? A. Yes, sir.

Q. And if they contain ingot molds you would make one spot inside your plant, wouldn't you, of the 12 cars? A. Well, one or two, probably two.

Q. And how many points of delivery do you have inside your plant for ingot molds? A. Well, we have ample storage, so that molds could be set off anywhere, since they are unloaded with a mobile crane.

Q. Now, when you receive a barge load consignment, how many trucks does it ordinarily require to bring that 750 tons into your plant? [21] A. To make the operation run smooth, it should run five trucks, a minimum of four.

Q. You mean they shuttle back and forth? A. Yes, sir.

Q. And how long does that take, generally? A. As a rule—I don't have the exact hours—I would say a day and a half.

Q. Is Neville Island your only source of supply at the present time? A. Yes, sir.

Q. What is the transit time for a barge movement from Neville Island to Owensboro? A. After the barge has been picked up by the tow, is that the question?

Q. Yes. A. Seven to eight days.

Q. And how long does it generally take at Neville Island to load the barge after it is spotted? A. I can't answer that.

Q. How long is generally required at Ownesboro to make the transfer of the tonnage? A. From a day to a day and a half.

Q. And what is the rail transit time from Neville Island to Steelton? A. I could only say approximately five to six days that is [22] including switching at the origin.

Q. On page 5 of your statement, sir, you say "If the proposed rate is approved and becomes effective, this company will allow the railroads to share in this business." Using the word "share" do you contemplate that you would divide this tonnage between the barge and the rail? A. Well, more or less. We haven't tried this yet.

Q. You haven't tried it yet? A. We haven't had a full train movement.

Q. In view of the difference in transit time and the difference in the unloading situation and delivery to your plant, what features of the barge service would induce you to pay them as much as you have to pay the rails for a much faster movement? A. Would you rephrase a little bit of that, sir.

Q. Do you want me to rephrase it or do you want him to read it? I will try to make it shorter. What would induce you to use a barge if you couldn't save any money in comparison with rail? A. Just past practice.

Q. You have never used a barge on a parity with rail up to this time, have you? A. We have always tried to keep at our mill equal transportation systems going, such as additional trucklines, they all share in the business.

Q. Let's ask you one more question about that. Can you point [23] out to me any specific siece of tonnage that you have received at your mill in the past where you have paid the barge line in combination with the truckline the same gross amount that you pay the railroads for the same traffic, can you give me one instance of that? A. No.

Q. So there hasn't been any traffic moving to your plant on a parity of rates as between barge and rail? A. No.

Q. But now you say there will be, is that your testimony? A. That is what I feel.

Q. What induces you to make that change? What is there about barge service that makes it attractive that you would pay the same amount that you pay the railroads for a much faster service? A. Well, this commodity isn't a matter of speed that we are speaking of. You are still buying in the same 600 gross ton lots.

Q. I understand you are. But you still have to take 750 tons for the barge load, and you still have the slow transit time. You say in spite of that you would pay the same rate to the barge company as you would pay to the rails? A. That is the way I felt at the time I made the statement.

Q. You have never done it before, though? A. No sir.

[24]

Q. Do you have one additional transfer of the cargo to make when you use the barge? A. We have the transfer at the Owensboro River Rail Terminal from the barge to the trucks.

Q. Are you familiar with the loading situation at Neville Island? A. No, sir.

Q. How long have you been with the company, Mr. Westerfield? A. Since 1953.

Q. Are you receiving any other traffic now by barge other than those ingot molds? A. No, sir.

Q. Have you in the past had occasion to ship billets from Steelton to Beaumont and Houston, Texas? A. Yes sir.

Q. And did you use the barge service for that movement? A. Yes, sir.

Q. The rail rates on billets from Steelton to Houston or Beaumont were reduced in October 1963, were they not? A. Yes, sir.

Q. And have you used the barge service since? A. No sir.

Q. At the present time there is a spread of $1.05 a ton, is there not, between the all-rail and the barge rate? A. Yes —you are speaking of the 600 gross ton rate?

[25]

Q. On the billets, I am speaking of. A. I think I can clarify this question why we aren't shipping billets by barge.

to Houston and Beaumont at the present time. Our tonnage —our sales in those areas have been reduced to approximately 400 to 450 tons. And when you figure your costs on that it's cheaper to ship by rail. So that is the way we ship. If we had more tonnage down there, more business, then we would ship by barge.

Q. If you could make the barge minimum? A. Yes, sir.

Mr. Ames: That is all I have, Mr. Examiner. Thank you.

Exam. Dishman: Is the barge minimum 600 gross tons?

The Witness: Yes, sir.

Exam. Dishman: What would that be in net tons? I believe Mr. Ames said something about 750.

Mr. Ames: 600 tons, Mr. Examiner. He is speaking of the Houston/Beaumont rate on billets.

The Witness: Yes, sir.

Mr. Ames: Not this ingot mold rate

To get the gross tons from net tons you multiply it by 112, and the other way around you divide it by 112. That is the conversion table.

Exam. Dishman: Now, what is the storage capacity of ingot molds at your plant? You store outside?

The Witness: Yes, sir.

[26] Exam. Dishman: Is it unlimited?

The Witness: You might say unlimited. For the amount we buy we have ample storage.

Exam. Dishman: Any other questions?

Mr. Helmetag: I just want to ask one question for clarification.

What is the minimum weight for the barge shipment of ingot mold from Neville Island to Owensboro, the barge minimum rate?

The Witness: Well, as I understand, they have 600, 500, 400, and possibly 3. I don't know if that is still in effect or not, I would say it is.

REDIRECT EXAMINATION

By: Mr. Leigh

Q. I would like to have a clear statement, Mr. Westerfield, of the operation at your plant when cars are delivered

to you. The question was asked you respecting the spotting of cars inside your plant. Do you use your own locomotives for taking these off the interchange and spotting them? A. Yes, all interplant switching is done by our own locomotives.

Mr. Leigh: I have no further questions.

Exam. Dishman: Do you offer the exhibits?

Mr. Leigh: Mr. Examiner, I would like to offer in evidence the exhibits marked for identification numbers 3, 4, and 5.

Exam. Dishman: Without objection they are received.

(Respondent's Exhibits No. 3, 4, and 5, were received in evidence.)

Exam. Dishman: And the witness is excused.

(Witness excused.)

* * *

[34] CHARLES D. BOWMAN

* * *

DIRECT EXAMINATION

BY MR. LEIGH:

* * *

[40] CROSS EXAMINATION

* * *

BY MR. AMES:

* * *

[42] Q. In preparing for this case did you give any consideration at all to fully distributed costs? A. I worked up the fully distributed costs, that is right.

Q. Now, taking as a starting point the out-of-pocket cost figure of 483-1/2 cents, how would you convert that to fully distributed cost, what would your answer be? A. As the cost under the so-called constant expenses.

Q. Could you give me a figure on that, how would you convert it.

Mr. Helmetag: Mr. Examiner, I object to this questioning. It is our position here that the fully distributed costs are completely irrelevant to the issues that are before the Commission in this case, that they have no relevance whatsoever, and that

any question with respect to what the fully distributed costs might be computed by one formula or another is irrelevant to the issue before the Commission in this proceeding.

Mr. Ames: I appreciate that is the railroad's position, but it is certainly not the barge line's position, and I don't [43] believe it is the Commission's position or the Court's position.

Exam. Dishman: Objection overruled.

The Witness: The fully distributed costs as developed through rail Form A, using the eastern district for the Pennsylvania Railroad portion of the haul and the southern region for the L&N portion of the haul, is 759.3 cents per gross ton.

By: Mr. Ames

Q. And that would be – if I wrote that opposite the 483-1/2 cent figures I would have the comparison between the out-of pocket and fully distributed? A. That is right. You want only the constant cost, is that what you asked for?

Q. I am asking for fully distributed cost. A. That, sir, is what I gave you, fully distributed cost.

Q. And that would be 483½ cents out-of-pocket and 795.3 cents fully distributed? A. Yes, sir.

Q. Now, your figures for your terminal study, as I understand you, Mr. Bowman, are not based on any time study, they are based on figures given you by Mr. Kirchner? A. That is correct, sir. Now, whether or not he made a time study is not up to me to say.

Q. I understand that. You did not make one? A. I did not make one.

[44] Mr. Leigh: You couldn't have, could you?

By: Mr. Ames

Q. That is right, you couldn't have, because you didn't have traffic.

One more question, Mr. Bowman. On page 2 of Exhibit 7, your statement, you make this statement: "While not

conceding that Form A costs are true costs or are a proper basis or method for ascertainment of the actual costs of transporting any specific commodity between any specific points, some indication of the compensatory nature of the proposed rates may be obtained by a comparison of the latter with such costs."

Now, if the Form A does not in your opinion give you a true cost figure, what kind of information would you have to have to make what you would regard as a true cost figure? A. Well, the only true basis of a true cost figure would be the actual study of the actual move from the specific point, in this case Neville Island, to Steelton, Kentucky.

Q. That would have to be an actual study of an actual movement, then? A. That is correct, sir. That would give you the only true cost.

* * *

[65] WESLEY A. ROGERS

* * *

DIRECT EXAMINATION

BY MR. AMES:

* * *

[68] CROSS-EXAMINATION

BY MR. HELMETAG:

* * *

Q. But you are not indicating that the traffic barge lines can compete with the railroads for the railroads are handling without competition, are you? A. Oh, they have competition, motor carrier competition and competition between themselves, naturally.

Q. And competition from the shippers who have the right to handle it in their own vehicles? A. Priority competition.

Q. And market competition, that is, competition of substitute commodities, for example, oil for coal, and that type of thing? A. Well, the railroads are probably handling the oil as well as the other commodities, It is difficult to say.

Q. But you are not intimating or inferring that because the railroads are not competing with the barge lines for certain traffic that the railroads are handling that traffic without competition, are you? A. No, I don't believe so, if I understand the question.

Q. Wouldn't you agree with me that in today's transportation market, based on your experience, you can characterize as one of persuasive competition in which there is competition throughout the country. [71] A. Very keen competition.

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[82] JOSEPH G. ROZAITIS

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DIRECT EXAMINATION

BY MR. AMES:

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[87]

Q. Do you know what the Barge Form C formula provides with respect to special studies as a basis for making an adjustment as to the time period for those special studies? A. No, sir; I think that is left completely open.

Q. Doesn't the formula indicate at some point that the time period for any adjustment shown relatively long? A. That may be.

I believe there is a footnote on one of these schedules that refers to that. However, I would like to point out that the time period here extends over a period of—well, for the year 1962 and 1963.

Q. We will come to that in a moment. Let me come back to that question.

We were talking about the explanatory statement with respect to Barge Form C. And if you refer to page 1 of Exhibit 24 where it says "Summary Schedule," isn't it true that the explanation of this formula indicates that the expenses are 100 per cent out-of-pocket? A. Yes, sir.

Q. And that the only difference between the barge out-of-pocket costs computed by this formula and the barge fully

distributed is that with respect to the fully distributed costs there is an allowance for return on investment or an allowance for profit based on the operating ration of the [88] carriers? A. Well, I wouldn't put it quite that way. I would characterize it as saying that the cost before any application of a return on investment or application of an operating ratio would be more properly termed full barge costs. There is no element of out-of-pocket costs, because as you indicated before, these costs are considered to be 100 per cent variable.

Q. Now, the statement that specifically refers to that is found on page 1 under the heading "Summary Schedule" where it reads, "In the absence of studies showing the actual proportion which out-of-pocket expenses are total barge expenses, the operating expenses are treated in this formula in effect as though they were 100 per cent out-of-pocket." A. That is right.

Q. And then it goes on to say "The expenses including interest expense represent an average level which must be exceeded in order to realize profit." That is what it says, isn't it? A. Yes.

Q. The only difference between the out-of-pocket costs computed by Barge Form C and the fully distributed cost is that the fully distributed costs include an allowance for profit or for return on investment? A. No, sir; I would not accept the connotation of out-of-pocket costs, because there have been no studies made to show exactly at what point these costs do vary. We say we are [89] simply treating them as though they are 100 percent. I will not concede that they are 100 per cent.

Q. Whether you concede it or not, the formula treats them as if they were all 100 per cent out-of-pocket? A. Yes, if you want to use the term "out-of-pocket." Personally I don't believe that is the proper use of the term itself.

Q. You would rather call them variable or incremental costs? A. I would call them total expenses.

Q. That vary with the traffic? A. I didn't introduce the word "variable," I would say the total expenses.

Q. Now, the Rail Form A out-of-pocket or variable costs they include return "on investment," don't they? A. Yes, I believe they do.

Q. So that so far as a comparison of the two formulae are concerned, the rail out-of-pocket includes items of expense which would be referred to as fully distributed in the Barge Form C, isn't that right? A. To a certain degree, I believe it is 80 per cent.

Q But I am talking about the return on investment, that is treated as a constant or a fully distributed cost under the barge formula, but under the rail formula it is treated as a variable or out-of-pocket expense, isn't that right? A. I don't know, I don't know exactly how it is treated by Rail From A, whether the equipment is treated as 100 per [90] cent out-of-pocket, and the road 50 per cent.

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[135] DELBERT M. STEINER

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DIRECT EXAMINATION

BY MR. AMES:

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[136]

Q. All right, Mr. Steiner. A. I would like to explain a little bit of the rationale to my conclusions in Exhibit 32.

[137] The mere fact that a rate exceeds "out-of-pocket" cost does not impute to that rate a condition of compensativeness. However, any rate which fails to fully recover a reasonable "out-of-pocket" cost imposes a financial burden upon other traffic, causing other traffic to subsidize that on which the rates fail to recover out-of-pocket cost. Similarly, rates providing a relatively low unit revenue contribution also impose a financial burden on other traffic unless the rates generate a sufficiently large volume that the increased volume actually tends to reduce the average unit revenue contribution necessary from other traffic. Differential pricing will tend to maximize revenue contribution only if the increasing volume of traffic tends to reduce the average unit revenue contribution.

When two carriers of the same method of transportation (carriers having similar, if not the same, cost characteristics), compete for a given movement of traffic, a reduction in rate purely to divert the movement from the other is economically unsound unless the lower rate generates at least a proportional increase in volume. When each of the carriers have the same cost structure each has an equal opportunity to retaliate. Conceivably, each could reduce its rate to an "out-of-pocket" cost level, but not without impairing their net revenue. Such rate reductions can result in only short-term gains since neither could continue to offer the service over a prolonged period unless the increases in volume were at [138] least as great as the reduction in rate.

If one of these carriers were larger than the other, the larger carrier could sustain the loss over a longer period of time in order to force the smaller carrier to forego the competitive traffic. Even here the larger carrier could not continue the service at the lower rate indefinitely without increasing rates on the remaining traffic, or accepting the lower net earning.

When two carriers having significantly different cost characteristics compete for a given movement of traffic, a reduction in rate purely to divert the movement from the other is economically unsound unless: (1) the lower rate tends to increase the total volume of this competitive movement; or (2) the lower rate results in a more economic allocation of resources.

Since the reduced rail rate is no lower than the existing barge rate it is not reasonable to suppose that it will have any effect on the total movement of ingot mold from Neville Island to Steelton.

There is no indication, based on this record, the movement of the ingot mold by rail will result in a more economic allocation of resources.

Determination of inherently lower cost between two methods of transport requires the consideration of all elements of cost which will be affected by the rates charged by each of the [139] two methods of transporta-

tion. Cost characteristics of rail and barge carrier differ widely, but they have one thing in common: Their revenues must fully recover the cost of operation and the cost of capital if they are to provide a sustainable transportation service, both now and in the future.

Relative size of carrier and the degree of variability of cost are unreasonable and unsound economic criteria on which to determine the inherently low cost. Both represent short-term advantages which cannot be sustained indefinitely. The larger carrier has a greater ability to sustain short-term losses over a longer period of time, an advantage it cannot perpetuate without impairing its ability to continuously provide the transportation service.

Similarly, the carrier with the lower degree of variability, or greater proportion of constant cost, has a short-term advantage which cannot be sustained indefinitely. The apparent advantage is artificial. If the relatively larger constant cost results from either lack of utilization or from internal dis-economies of operation, the exclusion of constant costs places a premium on past investment or perpetuation of operating dis-economies.

Neither relative size nor degree of variability of costs are valid economic criteria for the allocation of resources.

The valid economic basis upon which to determine inherently low cost advantage is long-term total cost or full cost.

[152-153]

* * *

Q. Would you turn, please, to page 6 of your prepared statement.

Do I understand that table in the middle of the page to be 8 different methods of allocating constant costs? A. Yes, sir.

Q. Can you tell which of this list of 8 would be the proper one to use? A. I think you have to consider all possible methods.

Q. And this means there are 8, at least you have listed 8, and there are probably 800 different ways to allocate con-

stant costs, is that right? A. There is an infinite number of ways.

Q. Would you look at page 8 of the prepared statement, please. [154] In the second paragraph there I notice you have used the expression "national resources"? A. Yes, sir.

Q. Could you briefly define what you mean by "national resources." A. "National resources" are those physical resources of the country.

Q. You are here talking about the United States, I take it? A. Yes. This would be in manpower and in natural raw materials, and so forth.

Q. On page 9, Mr. Steiner, I find this statement: "The average total barge cost of 519.7 cents per gross ton is directly comparable to the average total cost of 687.9 cents per gross ton." I will ask you, this figure for the barge costs, does it include any kind of deficit figures, such as those for the passenger business. A. It would, if they had such-

Q. I am not asking you if, but does it? A. Not to my knowledge.

Q. Does it include any deficit for less-than-carload traffic? A. It wouldn't include that unless the carrier had a less-than-carload deficit.

Q. I am talking about this figure that you put in here. A. I do not know whether they have a less-than-carload business.

Mr. Ames: We will concede that it don't.

Mr. Leigh: Very well. Thank you.

[155] Q. Is there anything in this gross ton cost figure, anything in it at all comparable with roadway expense or investment. A. To the extent that they have to pay it.

Q. And what is that extent? A. I didn't compute their costs, so I am not familiar with what they put in. I am accepting his, I have accepted Mr. Rozaitis' costs as he developed them.

Q. Mr. Steiner, I am not arguing with you, but you have made a pat statement here that these two figures are directly comparable, and I want to know the basis for that remark.

A. They were computed upon the basis, as I have explained in the statement, of the total operating expenses, rents and taxes, and a four per cent return on investment.

Q. Now, is there anything in there comparable – you say it is directly comparable – A. The method is directly comparable–

Q. –with the rails. I want to know what proportion of this barge cost is comparable to the road investment of a railroad.

Mr. Ames: I submit that he should have asked Mr. Rozaitis that question.

Mr. Leigh: I submit that this witness is using figures and drawing conclusions from them and putting statements in this record that are not accurate, and all I am trying to do is get at the bottom of it. And I think I am entitled to [156] ask this witness about figures he has chosen to use.

Mr. Ames: I submit that he should have asked the question of Mr. Rozaitis.

Exam. Dishman: You stated, did you not Mr. Witness, that you simply accepted Mr. Rozaitis' figure as he developed it?

The Witness: Yes, sir; as representing the total operating expense, rents and taxes, plus four per cent return as developed in the barge Form C from the reports to the Interstate Commerce Commission with such special studies as were necessary to complete the form.

Mr. Leigh: Mr. Examiner, I submit that this is an expert witness. Now, he has chosen to use a certain figure and make representations to this Commission about directness of comparability, and he knows perfectly well the answers to my questions.

Exam. Dishman: What was your question now?

By Mr. Leigh

Q. The question was this. Speaking of comparability, what does the barge cost figure you have cited here include that is anything like the equivalent of a railroad investment in its roadway.

Exam. Dishman: Do you know?

The Witness: Well, obviously a barge cost can't operate on a roadway, it operates on a waterway.

By Mr. Leigh:

Q. So there is no comparability, is that right? [157] A. The method is the comparability – I have said that this is a comparable method, if it is not clear, then I should make it clear that the method in computing the two are comparable.

Q. There is no roadway for the barge lines, and yet there is something to compare with the railroad's costs?

Mr. Ames: That has to do with the constituency of the figures, Mr. Examiner, that has nothing to do with –

Mr. Leigh: Mr. Examiner, I much prefer listening to the witness.

Mr. Ames: Well, I have a right to see that the question is clear and that it is proper.

Exam. Dishman: Is there anything more that you can say about that? You are talking about methods rather than identical figures?

The Witness: Yes, sir.

Mr. Leigh: And I am talking about methods too, Mr. Examiner. Obviously the figures are not the same.

Very well.

By Mr. Leigh

Q. Now, would you tell us what investments the barges have in the waterways. I will cite you your statement on page 9 in which you say this: "Rail full costs must include provisions for recovering operating costs as well as the cost of capital dedicated to the production of transportation services." Now, I am asking you, what investment do the barge lines have in the waterways over which they operate? [158] A. Specifically I do not know.

Q. Do they have any? A. To the extent that they have any expense over which they have control, then they would have.

Q. All right, supposing you tell us about these expenses. A. These expenses are listed in the annual reports of the barge lines.

Q. Do they go out and build locks and dams to let them up and down a river, for instance? A. No, sir; those are built by Congress.

Q. Is the answer to my question that the barges have no investment in the waterways? A. I don't know that they have no investment, but I know that they don't have a complete investment.

Q. If there is any at all it would be infinitesimal, wouldn't it be? A. As I understand it, they have facilities at their port sides and certain things like that. I don't know the extent of their investment in that.

Q. Do you know to what extent the Government takes care of those port facilities? A. No, sir.

Q. Let's put it very simple. Does any barge line you represent own any of the Ohio River, for instance? A. As a citizen of the United States, I would think that they [159] would.

Q. That is a very intelligent answer.

Mr. Steiner, could you inform us at this time how much money the United States has invested in the Ohio River as a waterway?

Mr. Ames: I object to it, Mr. Examiner.

Mr. Leigh: I asked him if he could do it, he can say yes or no.

The Witness: The answer is no.

By Mr. Leigh

Q. You wouldn't be concerned about that?

Mr. Ames: I have got the answer, let's not have the comment.

Mr. Leigh: All right, then, I will ask the question.

By Mr. Leigh:

Q. You wouldn't be concerned with the investment of the Government in the Ohio River as a waterway, would you? A. No, sir. It is not an expense of the barge lines to be recovered from these particular rates.

Mr. Leigh: I have no further questions. Thank you, Mr. Steiner.

CROSS-EXAMINATION

By Mr. Helmetag

Q. Mr. Steiner, I have just a few questions. Will you turn to page 1 of Exhibit 32. You state in your qualifications that you are a transportation economist. When you were asked to prepare your testimony in this case were [160] you asked to make representations to the Commission as an economist or as a cost analyst? A. I think one particular element of economics is cost. Cost analysis is as much a part of economics as the theory of macroeconomics or micro-economics – you can get into hundreds of fields. All of them are in the field of economics.

Q. Mr. Examiner, I think my question is a simple question. My question is, what type of representations was he asked to make to the Commission, was he asked to make representations as a cost analysis or as an economist? Now, that calls for a fairly simple answer, not a long discussion. I think we will get along much faster if we get answers to the questions. I don't like to quarrel about this. But that wasn't an answer to the question.

Just tell us, what were you asked to do? Were you asked to make a presentation to the Commission as an economist or as a cost analyst, which? A. I refer to myself as an economist. And when somebody approaches me, this is the type of service that I give.

Q. Do you regard the testimony that you have submitted which has been designated Exhibit 32, do you regard that as a statement of economic principles or as a statement related to the costs of these particular services? A. This predominantly relates to the examination of the cost data submitted by the railroads and the application of the [161] development of the constant costs for these particular operations.

Q. In the first paragraph you state that you have done some study in economics. What kind of economic study did you engage in? A. I have done micro-economics and macro-economics studies.

Q. The courses that you took in American University, what type of economic studies were those? A. They included

the theory of economics, econometrics, mathematical economics, there were two courses involving economic history and economic theory which were similar courses.

Q. Have you ever written anything in the field of economics as contrasted with the field of cost analysis? A. Yes, sir.

Q. Could you tell us – could you give us a list or furnish us with a list of those economic writings of yours, not necessarily now, but before the case concludes? A. Well, the preparation of material for the Post Office Department on the pricing of postal services.

Q. That is a Government monopoly service, isn't it sir? A. Yes, sir.

Q. Have you ever had any writing in the field of competitive economic pricing? A. Yes, sir.

[162] Q. They are the type of things that we would like to see. Would you give us a list of those publications? A. I prepared a paper for the American Society of Traffic and Transportation, I don't recall the precise title, but it dealt with determination of prices in a competitive situation between motor carriers and railroads.

I have also had a publication which has been published by the Practitioners Journal of the Interstate Commerce– the ICC Practitioners Journal which is entitled, "The Elasticity of Demand for Transportation."

Q. Now, on the second page of Exhibit 32 for identification you refer to the fact that you were employed as a transportation cost analyst with the Cost Finding Section of the Commission from 1946 to 1950. At the time that you were employed by the Commission did you do any work on the document which is now known as The Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs, which is Statement No. 7-63, the current version of it, did you do any work on that? A. Not on the current version.

Q. I mean with the– A. On the original material I helped prepare various portions of it.

tions of it.

Q. And did you work with Dr. Edwards at the time this statement and the cost formula known as Rail Cost Form A were being developed? [163] A. Yes, sir.

Q. At the time that you were with the Commission was any work being done on the so-called Barge Form C formula? A. No, sir.

Q. I have before me the current explanation statement, which is Statement No. 7-63. There were several earlier versions of this. I am referring to page 3 of this statement, referring to out-of-pocket costs, it makes this statement: "Whatever the term used, the figures have reality in rate-making only to the extent that they reflect added costs which were incurred because the traffic in question was handled or the costs which could have been avoided if the traffic were not handled." Did you participate in the preparation of that explanation of out-of-pocket cost as computed in Rail Form A, did you have anything to do with that statement? A. You couldn't pinpoint any particular statement in that book and attribute it to anything that I may have contributed to that. I was in the section at the time, and I sat in on discussions when these were developed, and there may be a word that I inserted or there may not have been

Q. Would you agree with that statement as being a sound representation of what is developed by the Rail Form A cost study? A. I would say that was the objective that they were attempting to achieve.

Q. That the Rail Form A so-called out-of-pocket costs develop [164] what in the economic field are known as incremental costs? A. I would not say incremental costs, because this has a rather special connotation among the economists.

Q. But the attempt in Rail Form A is to develop the costs of handling the added traffic, isn't that right? A. Again, transportation is so cluttered up with terms describing particular levels that I think the Commission did wise in adopting the term "out-of-pocket" which had not been given a large useage up until that time.

Q. Are you familiar with the statement on page 5 of this explanation which says that "The costs which are found to vary in direct proportion to out-of-pocket are designated in the cost studies as out-of-pocket," do you agree with that? A. Yes, sir.

Q. Then the reference to out-of-pocket costs in the Rail Form A study is to the costs which vary with the traffic, isn't that right? A. You have to take one step between what you have said and Rail Form A.

Q. What is the one step? A. And that one step is that you have assumed that 80 per cent of the expenses are variable, operating expenses, rents and taxes are variable, and that 50 per cent of the investment on road would be variable.

[165] But the formula – I am just trying to say what the formula attempts to do – the formula attempts to compute so-called out-of-pocket or variable costs, the costs which would vary with the traffic, the added units of traffic. A. That is the objective of the formula.

Q. Now, did you have anything to do with the Commission's explanation of the fully distributed costs or the cost sections explanation of fully distributed costs? A. All I can say is that I sat in on sections when it was discussed, and I read it, and at times gave comments. I couldn't tell you whether anything that I said was accepted or included.

Q. On page 24 of the current statement, Statement No. 7-63, which is in substantially the same as the earlier explanation, in referring to the constant cost it makes this statement: "These expenses remain unchanged, irrespective of whether or not particular shipments or classes of traffic are handled. In effect they are incurred on behalf of the operation as a whole. They can be only avoided by the abandonment of the entire operation, or at least a very substantial portion of it." And it goes on to say, "While such costs are obviously directly assignable to the carrier's operation taken in their entirety, they are not assignable on a cost of service basis to any particular shipment or class of traffic."

Do you agree with that explanation of the constant costs? [166] You can't ascribe them on the basis of the cost of service.

Q. To any particular type of unit of traffic? A. That is right.

Q. If they have any relation or any relevance, they relate to the operation taken as a whole, is that right, the constant costs? A. No. You are going beyond the statement there, I believe. These are costs that must be recovered in order to make the carrier whole.

Q. Will you tell us, then, what this statement of the cost section which is found on page 25 of the explanation means, which reads, referring again to fully distributed costs. "More important, however, their particular function is to provide a yardstick of what must be recouped in the long run from the operation as a whole, and so serve to measure the long-run compensatory character, not of a particular rate, but of the rate structure as a whole." What does that statement intend to imply in view of what was said before? A. I would interpret that to mean that when you are measuring the compensatory nature of a particular rate in the context of a rail operation – and you might say that this is in the context of a monopolistic competition – that you are attempting to maximize rail net revenue, holding all other elements constant, including competition. But you can't stop there. [167] You must at some point determine that the firm or the railroad or the group of railroads must come out whole.

Q. Doesn't this statement in effect say that the fully distributed costs have no relevance to determining whether a particular rate is compensatory, that they only have relevance when you are looking at the entire rate structure of the railroad to determine whether taken as a whole it will produce enough revenue to cover not only the variable costs of the moving of the traffic, but also the constant cost isn't that what the statement says? A. I think that would be a very narrow interpretation of it. There are many areas in which the allocation of constant cost or the determination

of the revenue need is a very important consideration in the determination of rates.

Q. In this particular litigation which is before the Commission we are not dealing, are we, with the rate structure as a whole of the railroads? Would you agree with that? A. You are not dealing with the rate structure as a whole, no, sir.

Q. We are dealing with a single commodity rate between two points, isn't that right? A. Yes, sir.

Q. Now, wouldn't you think that the rate that is before the Commission in this litigation is of the type in the statement I read to you, which is referred to as a particular rate? [168] A. I don't know if the reference which you are using "particular rate" relates into the statement that you have read but you would also have to add to it "all other things being held constant."

Q. We are dealing with a specific rate here, aren't we? A. A specific rate. And if you are going to measure its compensatory nature in this way, you must say that it is in isolation from all other factors.

Q. And according to this explanation of the cost section to determine the compensatory character of this particular or specific rate, you look to the out-of-pocket cost and not to the fully distributed cost, isn't that what the statement says? A. When you are looking at it in isolation of all other factors.

Q. But when you are looking at it to determine whether it is compensatory, which is what we are dealing with in the question I am asking, that is what you look to, the out-of-pocket costs, isn't that right, isn't that what the statement says? A. Well, I have not fully read the statement recently. But I could say that that is what the statement says.

Q. You don't disagree that that is what it says, do you? A. Well, I would have to read it carefully to make sure. I don't have it in front of me.

[169] Q. You spoke of the fact that you had dealt with a subject which is known as the elasticity of demand. This explanation which I have been referring to on page 26

makes this statement: "The apportionment of the constant and joint costs is fundamentally based on a weighing of the effect which the rates themselves would have upon the movement of the traffic and the carriers' revenues. Of far reaching significance in this latter connection has been recognition and the application of the principle that by reducing the rates on traffic, having expansible (elastic) traffic volume the contribution to the constant costs or revenue needs can be increased within limits beyond that attainable by limiting rate differentiation strictly to cost of service contributions."

Doesn't that say to you that the fully distributed costs have relevance primarily in the area of the elasticity of demand? A. Could I have that question read, just the last portion of it?

(The pending question was read by the reporter.)

The Witness: The question is, do the constant costs only have a relevance in the areas of elastic demand?

By Mr. Helmetag

Q. Elasticity of demand? A. Elasticity of demand. Not only.

Q. Not only. A. Predominantly, but not only.

[170] Q. Let me ask you a question, coming to this specific rate which is involved here. The record here shows that the railroads are not handling any of this traffic, that is, the volume traffic.

Mr. Ames: I object, Mr. Examiner. That is completely contrary to the record.

Mr. Helmetag: Let me put it this way. I am simplifying it.

By Mr. Helmetag

Q. The record showed and the barge witnesses testified yesterday to the effect that the barge lines are handling the overwhelming preponderance of this traffic, that the railroads have only handled a very few cars in emergency or special situations. Now, the evidence also showed that if this rate becomes effective, the railroads will divert from the barge lines a substantial portion if not all of the traffic that the barge lines are presently handling. The record also shows

that the rail rate will produce revenue in excess of the out-of-pocket costs as computed by Rail Form A. Now, I ask you whether the railroads will not be better off with this rate in effect than they are without it, or they would be without it? A. This would be a matter of the facts, that would have to be developed.

Q. Assume with me that the facts are as I stated, I ask you whether the railroads will be better off with this rate than without it? [171] A. You would have to go through the computation to make that determination.

Q. I am asking you to assume with me that the facts as I stated them, you don't have to make any computation to go through that situation. A. Well, the magnitude of each one of the facts you gave has a very important bearing upon the end results.

Q. You can't answer that question making the assumption that I made, you can't answer that question, sir? A. If you assume – this is the assumption that you are making, as I understand it – if one assumes, if you assume that the railroads are moving a small portion of the traffic now moving, the barge lines are moving the preponderance of it, with the change in rate the barge lines will move none, the railroads will move all. On the assumption that this added traffic will, merely by the fact that it covers out-of-pocket cost, adds to the rail net revenue or contribution, whatever you call it, cannot be determined by the facts you have given me without adding in the rates and actually making a computation as to what the effect would be in this situation. The facts are all there, it is just a case of making computations.

Q. Now, will you assume with me that this rate will produce revenues that will exceed the out-of-pocket costs by 40 cents a ton, just assume that it will show that. Now, would you agree with me that if this rate will attract to the [172] railroads a substantial part of all of the traffic that the barge lines are presently handling, that the railroads would be better off with this rate than they would be without it, can you answer that question, sir? A. You would

still have to find what they are getting from the present movement that they have, and how small it is, as compared with the potential movement.

Q. The evidence shows that they are getting about two carloads a year of the present traffic.

Mr Ames: The record doesn't show anything of the kind.

Mr. Helmetag: How much does it show?

Mr. Ames: Eight cars.

By Mr. Helmetag

Q. Eight cars a year under the present rates – and that this traffic is moving in a solid barge load almost per month. Now, would you say that the railroads would be better off under this situation. A. There would still have to be a computation made.

Q. Did you make any such computation? A. I haven't made such a computation as yet.

Q. You are not in a position, then, to state what the railroad situation will be as to whether there will be any contribution to the railroads net or to the burden as a result of this proposed rate. A. Well, if your question is merely to whether or not this rate would contribute to the overhead burden, to the extent [173] that it covers the Rail Form A cost it would contribute to the burden which is in excess of the Rail Form A cost level.

Q. And if it doesn't on a substantial number of units of traffic the railroads will be better off with it, won't they, sir? Doesn't it follow by definition? This isn't hard, is it? A. If you are assuming that this could do it, it is possible that they could do it.

Q. You don't have any doubt that it will, do you? A. Yes.

Q. You seriously have doubts that this rate is not going to make a contribution to the railroad's net, do you have a doubt as to that in view of what you heard yesterday? A. I have a doubt that it will make a greater contribution than the present traffic.

Q. You studied this proposition and listened to the evidence yesterday, and make that statement, sir? A. Yes, sir.

Q. I want to refer you to page 4 of your testimony. You make what appeared to be a criticism of the rail cost analyst when you say "Neither rail cost witness drew any conclusions as to whether the extremely narrow margin between the proposed rate and the out-of-pocket costs was an adequate contribution to rail constant costs for either carload traffic generally, for ingot mold traffic as a whole, or traffic moving between [174] Pittsburgh and the Owensboro area, or for the specific traffic here under investigation." Do you regard it as a function of the cost analyst to determine what a rate or what a price should contribute to the constant expenses of a carrier, is that the function of the cost analyst? A. The function of the cost analyst is not necessarily to determine how much, but he should determine whether it is adequate or not.

Q. Isn't it the function of the pricer of the service to determine how much contribution a particular price will make to the constant costs of the individual carrier? A. If he is fully aware of what the needs are; yes, sir.

Q. And isn't the contribution that will be made by any price to the constant expense of the company determined by the number of units that the price will generate, and the amount that the price will exceed the out-of-pocket costs of producing the service, isn't that the consideration? A. This is the basic consideration, it is the revenue contribution above the out-of-pocket level times the volume that gives you the gross consideration.

Q. And that is the judgment of the pricer, isn't it, sir, not the cost analyst? A. The cost analyst has to tell him what his revenue need is that he ultimately has to cover.

Q. It is not covered by any particular rate, but by the rate [175] structure as a whole? A. As a whole, and various segments of it can be measured as part of that whole.

Q. Now, sir, in the next paragraph on page 4 you say, "It is obvious that no carrier or group of carriers could operate for very long under a rate structure that merely approximates marginal (out-of-pocket) costs." You are talking about the overall rate structure there not a parti-

cular rate, isn't that so? A. Well, it becomes one of how many rates are at this level, the more rates you get at this level, the greater your volume has to be if you are going to actually cover your revenue needs.

Q. You didn't mean to indicate that any rate that would be below the fully distributed cost level would be unlawful or an improper rate, did you? A. I wouldn't want to commit myself on what lawful is.

Q. Would you say it was unsound or unreasonable from an economic standpoint? A. If it is an isolated exception it would not be unsound. If it is a general rule or becomes a general rule, then it becomes a different matter. It is the number of rates that are at this level that ultimately determines whether or not the carrier meets his revenue need.

Q. And isn't it in the nature of things that some of the rates would be above the fully distributed cost level and some would [176] be below the level, isn't that inherent in the statement you just made? A. Yes, sir; it changes continuously.

Q. And did you determine whether the rate is lawful or reasonable – leave out the word "lawful" – did you determine whether it is reasonable or economically sound as to whether it is below or above the fully distributed cost level, in view of what you said? A. You have two additional considerations to that which you have mentioned, as to just whether it is above or below. And that is as to whether or not this elasticity of demand to which you referred before is being fully – I hate to use the word "exploited" but I am using it in an economic sense and not in the sense of exploiting somebody just for the economic gain over them.

Q. The present barge rate that the carriers that you are representing are maintaining, it doesn't cover the barges fully distributed costs, are you aware of that? A. I don't know that I am specifically familiar with the rate itself and the comparison, I have also used it in conjunction with the added shipper expenses.

Q. Would you assume with me that it does not cover the barges fully distributed cost, would you say that it is an economically unsound rate for that reason? A. It is neither economically unsound or sound merely because [177] it covers out-of-pocket costs.

Q. It has been in effect for several years, and it has attracted a lot of traffic to these barge lines. Would it appear to you that it is economically sound in view of that? A. Well, when you say a lot of traffic, when you say 7 barge loads a year, I don't know whether this is a lot of traffic or not.

Q. If it has attracted all that is available or substantially all that is available, would you say that it is an economically sound price? A. It could be.

Q. Now, this rate which the barges are maintaining makes a smaller contribution to the barges fully distributed costs than the proposed rail rate will make to their fully distributed costs, will you assume that with me for the moment? A. Assuming that it does, you say?

Q. Yes. A. All right, I will assume that it does.

Q. Assume that with me. Now, would you say that in view of those circumstances the rail rate is economically unsound, the proposed rail rate? A. Do you want me to assume a situation where the margin above out-of-pocket cost of the barge rate is less than the margin above out-of-pocket cost of the rail rates?

Q. I want to ask, in view of that assumption – [178] A. That is assuming that both of them have the same revenue need or the same average, each making the same proportional contribution to constant cost.

Q. I am asking you, on the basis of that assumption alone whether you can say that the rail rate is economically unsound? A. You would have to add one more assumption to it before you could make –

Q. Just on the basis of my assumption, what would you say? A. On the basis of your assumption I would say that I could not draw a conclusion, because I would have to know the relative revenue need per unit of traffic of the two modes of transportation.

* * *

Q. Let me refresh your recollection on it. That figure is [179] made up of the barge fully distributed costs computed by using Barge Form C. Added to that is the shipper's expenses in moving the traffic across the dock at Owensboro, plus the shipper's expense in moving the traffic by truck from the dock at Owensboro to Steelton. Now, would you agree with me in view of what I have said that that figure of 519.7 cents isn't even a cost figure? A. It would be the cost of barge service to the shipper – it would be the barge cost plus the shipper's cost of getting it from the barge to his location.

Mr. Ames: Mr. Examiner, I believe I could save time there by concession . The barge rate, the tariff rate of the barge line, as I said yesterday, is a published rate, and we have backed that up with a cost study. On the ancillary services, so to speak, the unloading of the barge to a truck, and the truck movements to Steelton, we are assigning the cost to that movement on a pay-out basis. There is no attempt to conceal that fact at all, we believe that that is proper, and we believe it overstates costs, but we will not argue that.

Mr. Helmetag: We are not quarelling with that.

Mr. Ames: It is not a cost study, it is an ancillary service.

By Mr. Helmetag

Q. I am asking the witness is how you can say the two figures are directly comparable when one is made [180] up partly of costs and partly of charges to the shipper –

Mr. Ames: That is a matter of argument.

By Mr. Helmetag

Q. I am asking the witness how he can say that they are directly comparable? A. I am referring primarily there to the method by which the barge and the rail costs were computed. To get them from the same point to the same point they had to add to the barge costs this additional element to represent the additional expense incurred by the shipper or the receiver to obtain it at his location.

Q. Does it strike you as illogical or some sort of strange reasoning to say that two things are comparable when one of them is made up of costs and the other item is partly based on prices? Costs and prices aren't comparable, are they, or directly comparable.

Mr. Ames: I object, Mr. Examiner. This is pure argument.

Mr. Helmetag: It isn't argument.

Mr. Ames: I have told you very frankly that the ancillary costs are added to our barge costs on a pay-out basis. Now, we can talk about it forever, we can get into semantics, but that is it. What is the use of arguing about it?

Mr. Helmetag: It is like comparing oranges and pineapples.

Mr. Ames: I don't agree with that at all.

Mr. Helmetag: He is an expert.

Exam. Dishman: I think the record is clear just what was [181] taken into consideration in arriving at these figures.

You can't say anything more about it, Mr. Witness, than what you have already said?

The Witness: That is right.

By Mr. Helmetag

Q. Let me ask you, sir, did you have occasion to review the statements that I circulated last night of Dr. Baumol, Buchanan and Dr. Heflebower? A. I read them through.

Q. Are you familiar with any of the authors of those statements as economists? A. Only by their reputations.

Q. They have recognized standing in the economic field do they not sir? A. Well, there are quite a few –

Mr. Ames: What good is it if he says yes or no?

Mr. Helmetag: I am going to ask him if he agrees with them.

Mr. Ames: That doesn't make any difference, Mr. Examiner.

Exam. Dishman: What is the purpose of this questioning, Mr. Helmetag?

Mr. Helmetag: We are dealing here in this litigation with the economic principle to be followed by the Commission

in determining competitive adjustments. And I am glad the Examiner asked me about the relevance of this, because it goes to the very heart of this litigation.

The National Transportation Policy requires the Commission [182] in these inter-mode situations to recognize and preserve and foster sound economics in transportation. We are here trying to bring to the attention of the Commission the proper and sound economic principles to be utilized in judging the lawfulness and reasonableness of reducing rates of this type, and the only concern about their lawfulness is the impact on a competitor of a different mode. And it is to that problem that my questions are going. And I ask this witness to state as an economist – and also as to that problem we are presenting the testimony of several economists to show what are the sound economic principles to be followed in these competitive pricing situations.

Mr. Ames: I assume that that will all be treated as so much considering in the consideration of the case. But I still say, what difference does it make whether Mr. Steiner thinks Dr. Baumol is an Expert.

Mr. Helmetag: I won't pursue the question.

Mr. Ames: What do we get by that?

Mr. Helmetag: I have no further questions.

Mr. Ames: I have a few, Mr. Examiner, if you want to declare a recess.

Mr. Helmetag: Before we go, Mr. Examiner, I have a problem – maybe I could ask Mr. Ames about it.

Exam. Dishman: Off the record.

(Discussion off the record.)

[183] (Whereupon, a short recess was taken.)

Exam. Dishman: The hearing will come to order, gentlemen.

Mr. Helmetag: Mr. Examiner, before the recess the Witness Steiner was temporarily removed from the stand in order to permit Dr. Baumol to testify.

WILLIAM J. BAUMOL

was duly sworn and testified as follows:

Mr. Helmetag: Mr. Examiner, yesterday at the close of the hearing we circulated the statement of William J. Baumol to all parties. Let me ask the witness a couple of questions regarding it.

DIRECT EXAMINATION

By Mr. Helmetag

Q. Would you give your name and business address for the record, please? A. My name is William J. Baumol. And my business address is Department of Economics, Princeton University, Princeton, New Jersey.

Q. And have you, sir, prepared a written statement for presentation in this proceeding which is pending before the Commission here today? A. I have.

Mr. Helmetag: Mr. Examiner, may we have the statement of William J. Baumol marked for identification as Exhibit No. 37?

Exam. Dishman: Exhibit No. 37, Respondent's.

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* * *

CROSS EXAMINATION

By Mr. Ames

Q. Dr. Baumol, I want to get on as far as I can with you, and I am going to try to avoid argument. And I yield to no one in my ignorance of cost findings. I am just going to try to ask you some questions from the standpoint of a layman. Have you ever been in the employ of a barge line? A. No, sir.

Q. Or of a railroad, that is, other than this one? A. Not except in this sort of situation.

Q. I mean from the standpoint of being a regular employee. A. No, I have not, sir.

Q. Have you ever been called upon in any capacity, whether as an economist or otherwise, to fix a freight rate on a specific commodity? A. No, sir.

Q. Have you ever had the experience of trying to urge a potential shipper to use a particular route? A. No, sir.

Q. Now, from the standpoint of the gross revenue which a railroad takes in, do we have the freight revenue, the passenger revenue or loss, credits for joint facility rents, and miscellaneous items? I am talking now about the total intake of [185] a railroad? A. Yes, sir.

Q. Have I correctly described the items? A. I don't know, sir.

Q. Well, how would you describe them? A. I am not here as an expert on the operation of railroads, I am here as an economist, and I am not prepared to give an account of the full nature of the revenues of the railroads.

Q. Well, in order to be in a sound economic condition, the railroad must take in more than it spends, mustn't it? A. Absolutely.

Q. The only thing that I am trying to develop at this point is to have you agree with me that the top figure from which you have to work is how much the railroad took in in the course of the year? A. Certainly.

Q. You could reduce that to ton mile revenue by just simply dividing the ton miles into it, couldn't you? A. The return per ton mile, yes.

Q. Now, from the standpoint of the money paid out it is also true, is it not, that that would consist of operating expenses, joint facility rent debits, taxes, interest on funded debt. Can you think of any other expenses that they have had besides those? A. I don't know, but it sounds plausible.

[186] Q. You have used in your testimony which I read last night the term "incremental expense." And again calling your attention to my ignorance of accounting methods, can I regard that as synonymous with out-of-pocket so-called? A. It is, for all practical purposes, synonymous with the definition which we heard read earlier.

Q. Now, do you agree with me, Doctor, that there is a substantial difference between what you called incremental expense and the total expense incurred by a railroad? A. Yes, indeed.

Q. Could that difference be described in your judgment simply as the difference between out-of-pocket costs and full costs, avoiding the use of this term "fully distributed" which seems to be anathema to you? A. For the operation as a whole, yes. For any individual segment of traffic the distinction is not meaningful.

Q. Now, following up that simple procedure I outlined of dividing your total ton miles into your total expense of total cost, you could arrive at a figure of, say, 20 mills a ton mile if it came out that way. A. All right.

Q. Now, assuming that the president of the railroad asked you if you thought it would be sound economics to put in a rate which would only return ten mills, or ten mills below the full cost, what would you do about that, what would you [187] tell him? A. I would tell him that it may very well be extremely sound for some particular segment of traffic, and that it depends upon the circumstances, including the elasticity of demand and the incremental cost, whether or not it is sound.

Q. Now, if, following your advice, he did reduce that rate to the point where it only earns ten mills as compared with 20 mills full cost, you will agree with me, will you not, that the difference between those two figures of 10 mills must be recovered somewhere along the line? A. Certainly. This is assuming we are dealing with one particular segment of traffic.

Q. Yes. Now, if the railroad made enough of these reductions below their full costs, and approaching their bare out-of-pocket costs, they could eventually get into trouble, couldn't they, economically? A. Certainly.

Q. Now, do you agree with me that a railroad cannot possibly show a realistic profit unless the actual revenue it receives exceeds the total amount of money which it spends? A. Certainly.

Q. Would you turn to page 10 of statement, Doctor. About the middle of the page you make this statement there: "This purpose is, of course, to prevent any carrier from pricing at a level so low that its operations would not

be [188] viable, and where the sole purpose of such a non-compensatory rate is to drive out competitors." Now, let me ask you, Doctor, what do you mean in this context by the word "viable"? A. I mean precisely what you have been getting at, that the rates should be such as to permit the revenues to cover the costs of the road.

But if I may expand on this point –

Q. You certainly may. A. There are many occasions whereby refusing to provide services at a rate just slightly above incremental costs, the railroads would be making it more difficult to conver their total costs, because by taking on traffic whose total yield, that is, whose incremental yield is greater than its incremental cost, it adds that much to the net contribution to profits as constant or overhead costs.

Q. You will agree, will you not, that you can't carry this out-of-pocket cost theory too far, if you get too much of your traffic out-of-pocket you are in trouble, aren't you? A. No, on the contrary, I would say that if you do not follow it in an appropriate manner, taking again appropriate account of elasticity demand, you are refusing to earn maximum profits, and if maximum profits don't cover your total costs, then no revenues will cover your total costs.

Q. But don't you have a sinking sensation there? [189] A. Not at all, sir.

Q. If you get enough of your traffic – say you get 90 per cent of your rates – is running at a cent or two a ton above costs, out-of-pocket costs – A. Remember, we are talking about –

Q. Let me ask the question. Are you telling me that that railroad would not be in trouble? A. If we were talking about rates, and rates were set as incremental costs throughout, the roads would be in trouble. But we are not talking about rates, we are talking about floors to rates.

Q. Well, I am talking about rates, you may be talking about floors, but I am talking about rates. And we are agreed, then, aren't we, that if we have 200 rates in your total consist that are barely above out-of-pocket you are in trouble? A. That is right. Nobody is proposing to make all of them, or most of them equal –

Q. In this case because you have but one commodity? A. That is right.

Q. But you could do it one commodity at a time? A. Certainly.

Q. And as long as you had that one commodity you would still be all right in your judgment? A. You could be, yes.

Q. Now, by the term "non-compensatory" used in that quotation – [190] do you want me to read it again? A. No, I am familiar with the quotation.

Q. Do you mean there that it would be non-compensatory for the railroads to establish a rate below out-of-pocket costs? A. That is right.

Q. Even though it is only one commodity involved? A. That is right, because the road would then be putting out more money for that purpose than it takes in.

Q. Couldn't we be like Woolworth and take a small loss but get a big volume? A. It doesn't work that way.

Q. Now, I don't know whether you have seen this exhibit of Mr. Rozaitis, Exhibit 24, which carries an explanatory statement of Form C? A. No, I have not seen it.

Q. Under the summary schedule section there –

Mr. Helmetag, will you show him where it is.

Mr. Helmetag: Yes, I will.

Mr. Ames: It is page 1 of the exhibit, on the right-hand side, under "Summary Schedule," this statement appears: "In the absence of studies showing the actual portion which out-of-pocket expenses are of total barge expenses, the operating expenses" – meaning barge expenses – "are treated in this form in effect as though they were a hundred per cent out-of- [191] pocket."

By Mr. Ames

Q. Would you keep that statement in mind, please, for the purpose of this question? A. Yes, sir.

Q. Now, inasmuch as the out-of-pocket costs for water carriers are generally regarded as a hundred per cent of their cost of doing business, whereas, out-of-pocket costs on the rail side depend upon the purpose for which they were sub-

mitted, those out-of-pocket rail costs range from 50 per cent to 80 per cent of total costs. Would you regard, then, the out-of-pocket cost equation for each type of carrier, both water and rail, as a fair basis of comparison? A. No, sir; because there is no – these are arbitrary figures to a large extent – for example, the one that you read to me – and I see no reason why you should be able to compare arbitrarily constructed figures and get some meaningful conclusions from them.

Q. Now, having in mind your theory of pricing and my theory of rates, which to me mean the same thing, I want to give you a hypothetical case and ask you how you feel about it.

Molasses is shipped in great quantities from New Orleans to northern destinations. To Peking, Illinois, it is around 900 miles, and there is keen water competition on that movement, and the rate is – we will put it as $10 a ton. To Wichita, Kansas, as a typical interior point where they use [192] molasses to make cattle feeds, the distant is still 900 miles, but the rate is $20 a ton. Now, having in mind the fact that there is competition at one point with water, and no water competition at the other point, under your theory, I take it, it would be perfectly proper to put in that $10 rate to Peking, Illinois? A. It would be proper. It isn't necessary.

Q. It would be good costing, good economics? A. No, I am not arguing that rates should be equal to incremental costs, I have argued that rates have to be no lower than incremental costs, and the fact that rates in some cases approach incremental costs may be desirable both from the point of view of the area and the point of view of the economy.

Q. I think we are going together so far. Let's assume that the all-rail costs for both 900-mile movements, that to Peking and to Wichita, are $9. To Peking they put in a rate of $10, one dollar over, and to Wichita they put in a rate of $20, $11 over. Now, in your concept of pricing I take it that that would be perfectly all right. A. Yes, sir. In

fact, I would argue that the fact that some freight is shipped at a lower cost may be of advantage to the shippers on the higher cost line, because by making a contribution to profits and overhead on the lower cost line they are making it cheaper for the others to help cover the total costs of the railroad.

[193] Q. You would have a right hard time selling that to the Wichita man, wouldn't you? A. No, not if he knows that if the other traffic were lost he would have to pay $15.

Q. Now, Doctor, in this case that we have under trial here today the record will show that the present rate on ingot molds from Neville Island to Steelton is $11.86 per gross ton all rail. The proposed rate is $5.11 per gross ton, or $6.75 lower. Now, the present all rail rate of $11.86 compares quite favorably with other all-rail rates, there is an exhibit in this case which makes that comparison. Under your concept of pricing or rate-making would you say that both of those rates would be all right, could be all right? A. They could be.

Q. It wouldn't occur to you, would it, that if out-of-pocket costs are a fair criteria that may be they were charging this fellow a little too much under the present rate? A. It is conceivable. I just don't know. I have not argued to begin with that out-of-pocket costs should be equated to rates.

Q. In your concept of competitive rate-making would you regard costs as the only real dependable criterion? A. No, sir.

Q. What others would you use? A. Elasticity of demand in particular.

[194] Q. But you have to bottom them all on costs as a starting point, do you not? A. Yes.

Q. Is it possible in your judgment to determine the true costs of handling one specific commodity from one origin to one destination? A. It is possible in principle to determine the incremental cost of carrying one commodity. It is not possible in principle to determine the full cost, because that involves arbitrary apportionments of overheads joint costs and a variety of other costs.

Q. The only way you can assign incremental costs to that specific movement is to take your average incremental costs and apply it to that movement, isn't it? A. No, sir; that is not how I would go about it.

Q. You mean you would get on a locomotive and study a movement of ingot molds from – A. I would certainly examine engineering, statistical costs, accounting data, and try to deduce data for that particular movement, and try to determine from those data what difference it made to the cost of that particular operation to increase its level, or to decrease it. I would not guess at them from an average of other movements.

Q. You have got me at the foot of the class now. One of the railroad cost witnesses in this case made the statement that it [195] is impossible to determine the true cost of handling any specific commodity, and I believe the Courts have held that. Do you disagree with that? A. It depends on what you mean by true costs, first of all, whether you are talking about true full costs, true incremental costs, true total costs.

Q. We will talk first about incremental costs. A. It is possible in principle to find the true incremental costs. In practice you can approximate it fairly well in some circumstances.

Q. In practice if you did indulge in the practice you would have to actually study that individual movement? A. Right, absolutely.

Q. And so far as you know there has been no study here? A. I don't know.

Q. Now, again from the standpoint of what you regard as appropriate pricing concepts, I want to ask you another hypothetical question. I am visualizing a railroad train, and on that train there is a car containing 40,000 pounds of lumber, wire nails, or what have you, and right back of it there is a car containing 40,000 pounds of transistor radios, much more valuable. The two are coupled with the coupling pin usually used on a railroad, and by the same locomotive, are going to the same destination, from the same origin. You

are not making the point here, are you, that the out-of-pocket [196] cost or the incremental cost in handling to cars under those circumstances would be different? A. They might conceivably be because of weight, perishability and a variety of other circumstances.

Q. Wait a minute. I told you the weight was the same exactly, so get that out of that. A. If you state that they are the same, then certainly the out-of-pocket costs will be the same.

Q. I have stated that they are the same weight, from the same origin, from the same destination – A. The same degree of reliability of pilferage, same degree of perishability, the same degree of a variety of other things – it is just not obvious on the face of it that the costs need be the same.

Q. Then you do concede that there could be a difference of out-of-pocket costs on those two cars? A. Yes, there could be.

Q. At pages 3 and 4 of your statement you make this statement: "There is no question that cost data are pertinent to railroad pricing and to any regulatory decisions in this area. The type of cost figure which is appropriate for use in this decision process is clear to economists, but it seems to have been beclouded by arguments presented to the Interstate Commerce Commission on behalf of various parties." That will include me. "This exhibit undertakes to explain the conclusions of economic analysis on this matter."

[197] Do you have that paragraph in mind? A. Yes, sir.

Q. Now, again in your concept the real, crucial, basic element that you have to consider there is the out-of-pocket cost? A. Yes.

Q. When the 1958 transportation act was under consideration in Congress Chairman Freas of this Commission appeared before the Committee on Interstate and Foreign Commerce, and he was asked his opinion as to what kind of costs should govern in the fixation of freight rates on competitive traffic. And he made this statement: "When-

ever conditions permit, given transportation should return the full cost of performing carrier service. Certainly full costs in the aggregate have to be obtained in our transportation system if it is to be kept healthy. In many instances, however, the full cost of the low cost form of transportation exceeds the out-of-pocket cost of another. If, then, we are required to accept the rates of the low cost carrier merely because they exceed its out-of-pocket costs, we see no way of preserving the inherent advantages of the low cost carrier.

"In any event, that other mode would be compelled to depress its rates below full costs in order to preserve its inherent advantages against the high cost form of transportation. This would mean that the carrier with the inherent advantages would be forced into an unhealthy situation, or that higher rates [198] would have to be charged on non-competitive traffic in order to make up the deficit, for certainly the full cost of performing transportation service must come from somewhere."

Now, I know, Doctor, that you have seen that. And I know what your answer is going to be. But you tell me right now in just simple language, you disagree completely with that, don't you? A. That is right.

Q. Then we don't need to carry it any further, then.

I am correct when I say that your views and those of Chairman Freas simply could not be reconciled on that particular point? A. In general, yes.

Q. Now, I have called your attention to the fact that the present rate in this situation of $11.86 is $6.75 higher than the proposed rate. And you said you thought that could be justified, that both rates might be proper? A. They might be.

Q. Now, you weren't basing that on any physical condition or transportation condition, you were basing it on cost considerations, I take it? A. What I am saying is that I have no evidence that they are improper – not that I have positive evidence that they are proper.

Q. You have used the term "maximize the contribution" quite a good deal, Doctor.

[199] And bear me out if I am correct in assuming that by that you mean the portion of the rate as above the incremental or out-of-pocket costs, is a contribution to net, so to speak. A. Yes.

Q. And in your judgment a rate could not be destructively competitive unless one, the railroads put in a rate below the incremental cost, or two, whether they put it in for the purpose of driving out a competitor. A. I take it your question is –

Q. You say that in here somewhere. A. I am just a little puzzled by the construction of that question. But I take it you are saying – you are attributing to me the view that a rate cannot be destructive unless it is below incremental cost, and it is intended to drive out competitors?

Q. Right. A. I agree.

Q. Well, how would you know whether they intended to get that result? They would probably say that they never intended any such thing. A. Well, that would still prevent the rate from being below incremental cost.

Q. Then they would only have to have one, out-of-pocket cost. A. To prevent it, certainly.

[200] Q. On this out-of-pocket pricing, it is very easy to price an individual movement if you can just utilize that movement and consider it in a vacuum. But in your studies or in your thoughts on this subject, do you agree that you would have to give some consideration from the economic standpoint to the question whether that reduction would cause a downward spiral in other rates? Did you in your approach to this give that matter any consideration at all? A. Certainly in general one considers this, yes.

Q. You would have to as the manager of a railroad, would you not, take that into account? A. Yes.

Q. And I take it that when you used the term "profit" in your treatise here you had reference to maximizing the contribution? A. Yes.

Q. In other words, you didn't, when using the word "profits," you didn't jump above the full cost plateau, you didn't get up in there at all, did you? A. No. The full

cost – presumably some of the contributions, if they are sufficiently large, will make a net profit in the sense of more than covering full costs.

Q. I don't know that we are together yet. Would you agree with me that when you use the word "profit" in this statement that we can regard it as synonymous with a contribution to overhead? [201] A. Well, an increment to profit is an increment to the payment of overhead. It is total profit for some of those increments which can then be compared to total cost.

Q. Now, on page 13 you make this statement, Doctor: "It is impossible to implement a policy calling for rate regulation on the basis of the costs of 'the low cost carrier', because there is no valid procedure which can identify the carrier whose operating costs are lowest."

I am a little baffled by that. Do you mean that it is impossible where the competition is between a rail carrier and a water carrier to determine their respective costs. A. On a comparable basis, yes.

Q. Why do you say that? A. Particularly if you are dealing with full costs, because these involve arbitrary allocations and apportionments of the overhead burden.

Q. I am not talking particularly of full costs, I am saying to you, are you making the point here that it is impossible to determine the incremental or out-of-pocket costs of the respective carriers. A. It is impossible because you have to get the relevant comparable incremental costs. You would have to take account, for example of public costs.

But from the point of view of society, the relevant comparable costs are the relative usages of the nation's resources [202] and the nations resources include both public as well as private resources.

Q. The point you are making there in that sentence I believe I understand now, that there can be no proper basis of comparison because on the water side of the equation no account is taken of public costs such as dredging? A. Yes.

Q. And this is why you made that statement then, am I correct in that? A. Yes.

Q. Now, as a practical business proposition as it is used in the higher level of economics, when you say something costs a man something, don't you have in mind what he is paying out? A. Yes. But if we are talking about public policy we have to take into account much more than what that man is paying out.

Q. Well, it is real cost to him is what he pays out, isn't it? A. But the basis for public policy in rate making is not just what he pays out.

Q. I understand your position there. But I still say that the water carriers cost is out of his pocketbook, or what he pays out of his pocketbook? A. Yes, certainly.

Q. I am trying to think whether I should ask you this question or not. In the back here you have a little pamphlet called [203] "The Role of Costs in the Minimum Pricing of Railroad Services," and that includes your name among quite a number of economists there, including Ford Edwards? A. That is right, sir.

Q. Was that contribution made by these various gentlemen without any compensation at all, just as a public service? A. No, sir.

Q. Was it paid for by the railroad? A. Yes, it was.

Q. Then you and I are objective with each other, aren't we? A. Yes.

Mr. Ames: That is all I have.

Mr. Helmetag: I just want to ask two questions on redirect.

REDIRECT EXAMINATION

By Mr. Helmetag

Q. Referring to page 13 of your statement, Mr. Baumol, you talk about the difficulty of comparing the cost of different agencies. One of the factors that contribute to that difficulty is the fact that the different agencies may provide a different quantum of service, isn't it? A. Absolutely.

Q. Is that what you meant when you talked about the vast structural dissimilarities? A. Yes. This is certainly an important component. The answer to the question

I was asked I took to mean whether it was [204] possible in principle to compare incremental costs of one carrier with another. My statement addresses itself to the practical difficulties of comparison of incremental costs of one carrier with another. There is just no question that the accounting difficulties, that the complications arising from the services provided by different agencies, make it for all practical purposes impossible to get a comparison in practice between the incremental costs of different carriers.

Q. You didn't mean to infer, did you, sir, that you couldn't compute the incremental costs of one agency and also compute the incremental costs of another? A. No, sir.

Q. But when you try to compare the two the difficulty arises, is that right? A. That is right.

Q. I think this is clear in your statement, but there is no question in your mind about this, is there, that a reduction in rates can be made whereby the amount per unit above the incremental cost is lower as a result of the reduction, and still the carrier will be better off, there are situations where that occurs, isn't that right. A. There is no question. If you were formerly making a net of $2 a piece on a hundred tons, and you then reduce rates so that you make a net of one dollar a piece on 10,000 tons, you are clearly ahead.

[205] Q. Mr. Ames asked you one question about the rate that was intended to drive a carrier out of business. Is it your statement that that would be a destructive competitive practice? A. It depends upon whether you are talking of legal definitions, because I am in no position to comment on legal definitions.

Q. But this much you have no question about, that if the rate is below the properly calucated incremental cost, it is destructive competitively? A. Certainly its effect may be destructive.

Mr. Helmetag: I have nothing further.

Exam. Dishman: Do you want to offer the exhibit?

Mr. Helmetag: Yes. I just wanted to be sure that Mr. Ames didn't have another question.

Exam. Dishman: You offer it in evidence?

Mr. Helmetag: Yes, sir.

Mr. Ames: I have no objection.

Exam. Dishman: It is received in evidence.

(Respondent's Exhibit No. 37, Witness Baumol, was received in evidence.)

Exam. Dishman: And the witness is excused.

(Witness excused.)

Mr. Leigh: Mr. Examiner, might I call attention to a problem that we had here. Dr. Edwards has illness in his family and he is quite anxious to go back home just as soon [206] as he can. I have distributed a copy of Dr. Edwards' prepared testimony, I haven't yet handed it to the bench. I wonder if I could call him and have it qualified and have this statement marked as an exhibit, and then have Dr. Edwards return some other time for cross-examination, if cross-examination is desired.

Exam. Dishman: Is that agreeable, Mr. Ames?

Mr. Ames: I am agreeable to putting him on and having him identify the exhibit.

If we could go off the record a moment I might be able to suggest something that would help us all out.

Exam Dishman: All right, off the record.

(Discussion off the record.)

Exam. Dishman: On the record.

Mr. Leigh: I will call Mr. Edwards.

FORD K. EDWARDS

was duly sworn and testified as follows:

DIRECT EXAMINATION

By Mr. Leigh

Q. Please state your name and address? A. My name is Ford K. Edwards; address, 1111 "E" Street, Northwest, Washington, D. C.

Q. Dr. Edwards, have you prepared a statement to be introduced or offered in evidence in this proceeding relating to the economic theories involved in costing? A. I have.

[207] Mr. Leigh: Mr. Examiner, may we have the statement of Ford K. Edwards marked for identification?

Exam. Dishman: As Respondent's Exhibit No. 38.

(Respondent's Exhibit No. 38, Witness Edwards, was marked for identification.)

By Mr. Leigh

Q. Dr. Edwards, you heard Dr. Baumol's testimony—you have read his testimony as well as heard his cross-examination this morning? A. I have.

Q. And are you in agreement in principle with the testimony Dr. Baumol gave? A. I am.

Mr. Leigh: No further questions.

CROSS-EXAMINATION

By Mr. Ames

Q. I can only ask you, Doctor, whether the language – the language I know is different – but have you made any points over and above those made by Dr. Baumol? A. I have dealt with the same points, with illustrations that I thought would clarify it.

Q. But you would come out the same way? A. I would come out the same way, yes.

Q. And you would be willing to adopt his testimony? A. I would.

Q. Now, when did you leave the Commission, Dr. Edwards? A. In 1949.

[208] Mr. Ames: If the other side will agree with me, Mr. Examiner, that both of these statements are in support of the proposition that the fully distributed costs – that the out-of-pocket or incremental costs must be the governing factor in rate making, to the disregard of the fully distributed costs, or the full costs, if you want to put it that way, and Dr. Edwards will say that he would answer me the same way that Mr. Baumol answered me, from the standpoint of conserving time I am willing to excuse him. I do believe that if I get an opportunity sometime today to read this – I don't believe I really need that.

If you are willing to make the stipulation I have just outlined, I will waive the reading of it.

Mr. Leigh: We will so stipulate – unless Dr. Edwards has a statement to make.

The Witness: Yes. I would like to point out that on page 29 of my statement I made the observation that the proposed rate compares with the out-of-pocket costs introduced by the respective Pennsylvania and L & N cost witnesses, and that the margin of the rate over out-of-pocket costs is 9 per cent. I have taken it one step beyond that and stated that in my judgment those out-of-pocket costs would be excessive to the degree that they include an allowance for the return on the roadway property, the position being that the addition of this traffic would have no influence upon the roadway plant itself, primarily [209] the trackage, and that in arriving at the out-of-pocket or incremental costs of these two railroads to handle this traffic, the allowance is for return and on trackage would not be an incremental cost. And I have indicated the effect of excluding that, in which case the proposed rates would exceed the out-of-pocket cost, excluding road return, by 20 per cent.

Q. (By Mr. Ames): In that position you are in conflict with Form A as it presently is in force? A. No, Rail Form A provides that if there is no addition to road that factor may be included or excluded. That is in the basic instructions of the formula itself, that alternative is left open.

Q. You mean the accountant or the manager of the railroad can determine in his own mind whether the return on road property is germane? A. No, I mean by that that the analyst in applying the costs would make inquiry into that subject, whether the addition of this traffic would cause an expansion in the plant. I pointed out that the formula leaves that subject open as an alternative.

Q. I see. A. That is all.

Mr. Ames: Well, is the stipulation on the record, Mr. Examiner?

Mr. Helmetag: Mr. Examiner, there is only one question I have about the stipulation, and I think it is really one for [210] clarity and clarification. We are talking about the incremental costs in this proceeding as providing the cost floor for rates – they are the determining factor as to what the floor should be under the rates. We are not saying, as Dr. Baumol pointed out, that the rates should be fixed at the incremental level, they can vary upward from it, but we are talking about what is the relevant cost floor to be established by the Commission, and we say that in that area the incremental costs are determinative. That is the point we are making.

Mr. Ames: Well, when you speak of the floor of a railroad rate, and you isolate it, or treat it as though it were in a vacuum, then it becomes merely the question of the quantum of the rate. Our position here is that you have an intermodal competitive factor that you have to consider.

Mr. Helmetag: That is right.

Mr. Ames: And the question here is whether in that competitive posture you must consider the full cost rather than the out-of-pocket. Now, both of these expense witnesses have advocated that in that case you should only consider the out-of-pocket.

Mr. Helmetag: That is right, I agree with you.

Mr. Ames: And I take it that there is going to be no deviation from that.

Mr. Helmetag: None whatsoever. But what I am saying is that your reference to out-of-pocket costs as contrasted with [211] the fully distributed or full cost is to determine the floor for the rates. That is the point we are making.

Mr. Ames: There again I think when you use the term "floor" you are talking about isolation.

Mr. Helmetag: No, I am not talking about isolation, I am talking about the floor, not only absolutely, but the floor in these competitive situations, that should provide the floor in these competitive situations we are talking about.

Exam. Dishman: Is that satisfactory, Mr. Ames?

Mr. Ames: I have nothing further.

Exam. Dishman: Is the record satisfactory on this stipulation?

Mr. Ames: I think so. Of course, I take it most of that was on the record. Sometimes we are off.

Exam. Dishman: It was all on the record after Dr. Edwards took the stand.

* * *

DELBERT M. STEINER (recalled)

[213] * * *

Q. Now, on this question, Mr. Steiner, which Dr. Baumol testified, [214] disregarding the fully distributed costs, let me ask you this question. If you could isolate the particular rate situation entirely from the standpoint of constant costs, that is, consider only constant costs, and you could do that in relation to the movement of one commodity, couldn't you do it with the other commodities one by one? A. You are talking about the isolation of constant costs rather than variable costs, are you?

Q. Yes. A. In the matter of isolation of costs for a particular commodity movement you could take each one of them individually, and you could determine individually what the margin would be.

Q. And you would rationalize your action by arguing that you were only considering rates on one commodity? A. Yes sir.

Q. Now, one of the exhibits in this case, introduced by the Witness Rogers, shows that about 85 per cent of the total barge line tonnage is in 10 commodity descriptions. Well, following out that reasoning, you could repeat this 10 times and you would do the trick, wouldn't you, of getting the barge lines out of business? A. Well, if you set the rates at such a level that they couldn't compete for 10 commodities it would have a lot of impact on movement by barge.

Q. Even assuming for the sake of argument that in this case [215] the railroads would be better off with this proposed rate than without it – I am just asking you to assume that – don't you think it is proper also for the Commission to consider the effect of the rate on competitive modes of transportation? A. Yes, sir.

Q. Now, it is true, is it not, Mr. Steiner, that in the application of the barge line cost formula that the so-called out-of-pocket costs for barge lines is generally regarded as the full cost, exclusive of the return on investment? A. I think the term used is that it is treated as though it were 100 per cent variable.

Q. And the only way that the barge line has to expand that into what we might call full costs or fully distributed costs is to either add something for a four per cent return on investment or apply an operating ratio to it? A. This is what is suggested in the barge Form C.

Q. Now, after hearing Dr. Baumol testify do you have any comment to make on his presentation? A. Nothing in specific, sir, no.

Mr. Ames: That is all I have, sir.

Mr. Helmetag: Could I ask just a few questions on recross-examination, sir?

RECROSS-EXAMINATION

By Mr. Helmetag

Q. With respect to the barge lines, the [216] reason why the expenses are regarded as a hundred per cent variable is because the barge lines have no substantial investment in permanent facilities, isn't that the explanation for that? A. As I read the barge formula – and this is as much as I know about it – it indicated that no study had been made to determine the variable.

Q. But isn't that the practical situation, that the barge lines have no substantial investment in what might be called a permanent or virtually permanent facility? For example, let me give you this. Their barges that they have, they can add or subtract barges according to the amount of traffic that they have, isn't that the situation? A. Well, over a period of time they obviously could.

Q. In other words, if the traffic were to increase 10 per cent, if there is a likelihood that it would increase 10 per cent over 10 years, they could add 10 per cent more barges to take care of it, isn't that a fact? A. Well, that is true of any means of transportation as to equipment.

Q. That is true. And in the Rail Form A the equipment is treated as a hundred per cent variable, isn't that right? A. Yes sir.

Q. And the reason why the railroads have a substantial percentage of constant costs is because they have large [217] investments in facilities which are either permanent in nature or virtually permanent, such things as bridges, the roadway, the tracks, and that type of thing, isn't that true? A. I don't believe that accounts for the total amount of constant costs or the vast majority of constant costs.

Q. Well, it accounts for a substantial amount of it, isn't that so? A. It accounts for some of it.

Q. Because with respect to the 80 per cent that is used in the Rail Form A, that is based on a composit of percentages, treating the equipment as a hundred per cent variable and some of the other items as less than a hundred per cent variable, isn't it? A. No, the 80 per cent is not arrived at in that manner.

Q. Wasn't that the basis for the 80 per cent variable? A. No sir.

Q. You say that is not the fact? A. No, sir. The hundred per cent variability of equipment relates only to the return on investment, or the variability of investment. The 50 per cent variability of equipment relates to the investment, and the hundred per cent variability – excuse me – the hundred percent variability of investment and the 50 per cent variability of road relates to investment, not to operating expenses.

Q. Now, when the Commission cost section made the composit 80 [218] per cent ratio as representing the portion of the total expenses which are variable, didn't they base that on studies which treated some expense items as being a hundred per cent variable, and others being 50 per cent variable and some being 75, and that type of thing, and that the 80

per cent represents a composit of all these variability percentages? A. You have two things that you have put together to a conclusion that may or may not be right. You are thinking of back in 28,300, in which at that time each individual account item was given a per cent variable. In 28,300, if I remember the figures correctly, it came up with something like 76 per cent variable. When they came to the 80 per cent they were attempting to get at the same type of figure, but they did not work out all of the detail of individual accounts, they were analyzing aggregate expenses and the variability of aggregate expenses under varying conditions.

Q. It represents the business judgment of the Commission's cost section, based on a composite of the varying percentages that the various expense accounts are variable, isn't that right? A. No, it was the composite opinion of the Cost Section or the judgment of the Cost Section as to how the total expenses were variable, without looking at individual expenses separately.

Q. But when the original studies and formula were in process, it was the thinking of the Cost Section that various expense [219] items had different percentages of variability, isn't that so? A. In the original 28,300 investigation.

* * *

[220]

Mr. Examiner, we had a stipulation with Mr. Ames this morning to the effect that if Dr. Buchanan were asked the same questions as Dr. Baumol on cross-examination his answers would be substantially the same because his testimony relates to the same basic economic principle, namely, the use of incremental costs as the floor for reduced rail rates.

Is that satisfactory, Mr. Ames?

Mr Ames: Yes.

Exam. Dishman: Will you make that stipulation in regard to this witness?

[221] Mr. Helmetag: Yes, sir.

Mr. Ames: The same stipulation will be made as we had as to Dr. Edwards.

Exam. Dishman: Is there any question at all, then?

Mr. Ames: No.

Exam. Dishman: Do you offer the exhibit?

Mr. Helmetag: I offer Exhibit 39 into evidence.

Exam. Dishman: It is received in evidence.

(Respondent's Exhibit No. 39, Witness Buchanan, was received in evidence.)

Exam. Dishman: And the witness is excused.

(Witness excused.)

Mr. Helmetag: While I am here, in the interest of orderly procedure, I would like to have identified as Respondent's Exhibit No. 40 the statement of Dr. Richard B. Heflebower of Northwestern University which was circulated last night.

Exam. Dishman: That will be identified as Respondent's Exhibit No. 40.

(Respondent's Exhibit No. 40, was marked for identification).

Mr. Helmetag: Mr. Examiner, Exhibit No. 40 for identification, it is my understanding that Mr. Ames is willing to make the same stipulation with respect to it and have it admitted into evidence even though the witness, Dr. Heflebower, is not physically present. He could have been here tomorrow, and was prepared to be here, but to avoid having him come on, [222] I understand the stipulation will apply to him, and that the statement will be admitted into evidence even though the witness is not physically present.

Is that agreeable, Mr. Ames?

Mr. Ames: It is satisfactory to me.

* * *

SUPREME COURT, U. S.

No. 797

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

AMERICAN COMMERCIAL LINES, INC., ET AL.,
Appellants,

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY AND THE PENNSYLVANIA RAILROAD COMPANY, ET AL.,
Appellees.

On Appeal from the United States District Court for the Western District of Kentucky

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On Appeal from the United States District Court for the Western District of Kentucky

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JURISDICTIONAL STATEMENT

Appellants, American Commercial Lines, Inc., et al.,* appeal from a judgment of the United States District Court for the Western District of Kentucky which set aside an order of the Interstate Commerce Commission and remanded the matter to the Commission for further

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* The appellants are American Commercial Lines, Inc., Mississippi Valley Barge Line Company, Ohio River Company, Union Barge Line Corporation and Waterways Freight Bureau, by this document.

The appellees are the Louisville and Nashville Railroad Company, the Pennsylvania Railroad Company and forty-eight additional railroads that joined as plaintiffs in the lower court.

action not inconsistent with its opinion. Appellants submit this statement to show that this Court has jurisdiction of the appeal and that substantial questions are presented.

OPINION BELOW

The opinion of the three-judge District Court for the Western District of Kentucky, reported at 268 F.Supp. 71 (1967) (advance sheets), is reproduced here as Appendix A. The judgment of the district court is set forth as Appendix B hereto. The original report of the Interstate Commerce Commission, Division 2, is reported at 323 I.C.C. 758 and reproduced here as Appendix C. The final report and order of the Interstate Commerce Commission is reported at 326 I.C.C. 77 and reproduced here as Appendix D.

JURISDICTION

This action was brought by appellees pursuant to the provisions of 28 U.S.C. sections 1336, 2321-2325 to enjoin, annul and set aside an order of the Interstate Commerce Commission in Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa., to Steelton, Ky.*, 326 I.C.C. 77 (1965). The judgment of the district court setting aside the order of the Interstate Commerce Commission and remanding the matter for reconsideration was filed May 15, 1967. Notice of appeal was filed by appellants herein in the United States District Court for the Western District of Kentucky on July 13, 1967. This Court has jurisdiction under 28 U.S.C. 1253 and 2101(b) to review the judgment of the District Court on direct appeal. *I.C.C.* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744 (1963); *Mechling Barge Lines* v. *United States*, 376 U.S. 375 (1964).

STATUTES INVOLVED

The principal statutory provisions under consideration are: Section 15a(3) of the Interstate Commerce Act (49 U.S.C. Sec. 15a(3)) and the National Transportation Policy (49 U.S.C. preceding Section 1), both of which are set forth in Appendix E hereto.

QUESTIONS PRESENTED

The questions presented by this appeal arise from the opinion and judgment of the District Court which set aside and permanently enjoined the order of the Interstate Commerce Commission in *Ingot Molds, Pa., to Steelton, Ky.*, 326 I.C.C. 77, 323 I.C.C. 758, and remanded the matter to the Commission for action not inconsistent with the Court's opinion. The questions are:

1. Did the District Court err in holding that the Commission failed to state a rational basis and make adequate findings to support its conclusion that full costs of two competing modes must be compared to determine which mode has the inherent cost advantage within the meaning of the National Transportation Policy?

2. Did the District Court err in holding "that the Commission has failed to state a rational basis to support its selection of the 'fully distributed' costs of the barge-truck mode as the floor for reduced railroad rates"?

3. Did the District Court err in holding that the Commission's use of full cost to determine which mode possessed the inherent advantage is contrary to *Interstate Commerce Commission* v. *New York, N. H. & H. R.R. Co.*, 372 U.S. 744, 760-761 (1963)?

4. Did the District Court err in holding that the Commission misinterpreted and misapplied the Transportation Acts of 1940 and 1958 in comparing the

full costs of competing modes of transportation to measure inherent advantage?

5. Did the District Court err in holding that the Congress intended to restrict the power of the Commission, without discretion, to determine the lawfulness of competitive rates under Section 15a(3) of the Interstate Commerce Act to consideration of a single test—whether such rates are above out-of-pocket costs.

STATEMENT OF THE CASE

Appellants, American Commercial Lines, Inc., Mississippi Valley Barge Line Company, Ohio River Company, and Union Barge Line Corporation are certificated common carriers authorized by the Interstate Commerce Commission to conduct water carrier service between ports and points on the Mississippi River system. Waterways Freight Bureau is a voluntary non-profit organization, composed of common carriers by water engaged in the transportation of freight by barge. The principal functions of the Bureau relate to rate-making procedures.

Proceedings Before The Commission

This proceeding relates to a movement of ingot molds and ingot mold stools from Neville Island and Pittsburgh, Pa. to Steelton, Ky., for which both appellee railroads and certain of appellant barge lines have competed. From the time that the plant of the receiver at Steelton became operational in 1953 until the reduced rail rate which is the subject of this action became effective in 1965, the ingot molds traffic, other than sporadic emergency shipments moved via the barge-truck route. Although more recent traffic statistics are not here of record the Commission found, and it is not disputed, that the great preponderance of the traffic would be diverted from the barge-truck to the rail route. (326 I.C.C. at 80, App. 53)

It was with a view toward capturing this traffic that the Louisville and Nashville and Pennsylvania railroads, plaintiffs below, proposed a reduced rate on ingot molds from Neville Island and Pittsburgh to Steelton of $5.11 per ton, in single shipments of not less than 600 gross tons, minimum weight 112,000 pounds per car moving in 12 cars or less at one time. At the time that this rate was published, to become effective originally on December 1, 1963, the applicable rail rate on this commodity between the involved points was $11.86 per gross ton, minimum weight 100,000 pounds per car. The total charge for movement via the barge-truck route was $5.11 per ton, composed of a barge rate of $3.32, minimum 600 gross tons, a transfer charge of 95 cents at Owensboro, Ky. and a truck charge beyond of 84 cents. It is abundantly clear, therefore, that, notwithstanding the several "incremental" theories of rate making here advanced by the four economists for the railroads,* the rate under discussion was developed by the simple expedient of matching the barge-truck charges.

Upon protest by appellant, Waterways Freight Bureau, the proposed rail rate was suspended and placed under investigation by the Commission. Pending hearing upon the matter the statutory seven months suspension period was voluntarily extended by the rail respondents until after Division 2 of the Commission, on February 17, 1965, found the rate to be just and reasonable. Thereafter the railroads made the reduced rate effective on March 19, 1965, and it remains in effect to date. The report of Division 2 found, as did that of the entire Commission subsequently, that fully distributed costs of record constitute the appropriate method of comparing the inherent advantages of low cost in intermodal rate controversies. It went on to conclude, however, that inasmuch as the

* See Exhibits Nos. 37, 38, 39 and 40 and discussion thereof in the report of Division 2 (323 I.C.C. 758 at 761, App. 28).

barge lines had voluntarily maintained a rate producing charges below its fully distributed costs ($5.11 v: $5.19) they had, in effect, waived their right to protection against a matching rate by the higher cost rail mode.

Both the rail carrier respondents and the barge line protestants petitioned for reconsideration of the report of Division 2, the former to eliminate the standard of fully distributed cost as the measure of the low cost mode and the latter to reverse the Division's finding that the barge line had waived the right to protection of its inherent cost advantage. Upon reconsideration the entire Commission, by its report of November 9, 1965 (326 I.C.C. 77, App. 49), sustained the finding by Division 2 that fully distributed costs shall constitute the measure of inherent cost advantage within the meaning of the National Transportation Policy. The Commission likewise agreed with the Division that, by this standard, the inherent advantage of low cost lies with the barge-truck route. The Commission reversed the Division's report with respect to the alleged waiver, holding that an inherent cost advantage either exists or does not exist and is not to be lost by, as here, the inadvertent establishment of a rate below a carrier's fully distributed cost level. (326 I.C.C. at 83, App. 57-58) Accordingly, the Commission required that the reduced equalizing rate of the railroads be canceled on the ground that "by reducing its rate below the level of the barge-truck full costs, respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage." (326 I.C.C. at 85, App. 60) In view of its findings, the Commission denied the railroads' petition for reconsideration.

Proceedings Before The District Court

The two railroad respondents before the Commission, directed to cancel the reduced joint rate here in issue,

filed suit in the U. S. District Court, Western District of Kentucky, to set aside the Commission's order on grounds generally that it was based upon an unlawful and erroneous interpretation of the governing statutes and was lacking in a stated rational basis. (268 F.Supp. at 75-76, App. 6) Attesting to the importance of the intermodal controversy here presented, 48 additional railroads—virtually all the Class I railroads in the United States—intervened as plaintiffs in this proceeding. These appellants, together with the American Trucking Associations, Inc., the National Motor Freight Traffic Association, Inc., the National Tank Truck Carriers, Inc., the American Waterways Operators, Inc. were permitted to intervene in support of the Commission's order. The Department of Justice, for the United States, confessed error and participated before the District Court as an additional plaintiff.

The opinion and judgment of the three-judge District Court invalidating the Commission's action were entered on May 15, 1967. Notice of appeal was filed by these appellants with the District Court on July 14, 1967. By orders of the District Court, dated September 6, 1967 and of this Court, the due date for docketing the appeal was extended until November 9, 1967.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

A. The Commission's Interpretation Of Its Powers Under Section 15a(3).

There is here presented by way of a sequel to the opinion of this Court in the *New Haven case* (*I.C.C.* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744 (1963)) the question of the power of the Interstate Commerce Commission under Section 15a(3) of the Act to carry out the objectives of the National Transportation Policy, most particularly the recognition and preservation of the in-

herent advantages of each mode of transportation. In that case, where cost comparisons were absent, this Court, after a comprehensive analysis of the legislative history of Section 15a(3), concluded that it would not "decide in advance precisely how either carrier's inherent advantages should be measured or protected" but that "these and other similar questions should be left for initial resolution to the Commission's informed judgment." (372 U.S. at 760)

The decision of the District Court below would deprive the Commission of the power to make the choice between fully distributed and out-of-pocket costs to which this Court was there referring and *require* approval of "rates which are compensatory, i.e. above relevant out-of-pocket costs," *without any determination as to which of the competing modes of transportation possesses the inherent advantage.* Thus, in nullifying the Commission's order on the ground that it allegedly misinterpreted the Congressional intent and misconstrued this Court's opinion in *New Haven*, the District Court would deny to the Commission the power to make *any* "initial resolution" of either the *fact* or the *measure* of relative inherent advantage, contrary to the clear finding of this Court in that case.

It is submitted that in thus circumscribing the powers of the Commission the District Court has misinterpreted the pertinent statutory provisions, imposed by judicial fiat a standard which the Congress expressly rejected and frustrated the specific objectives of the National Transportation Policy. It is further submitted that the rationale of the Commission's election to employ fully distributed costs as the measure of inherent advantage, within the meaning of the National Transportation Policy, is fully disclosed in the report of the Commission. This appeal, therefore, brings before this Court the substantial questions of, first, whether the Commission misinterpreted

the Congressional intent and its statutory powers under Section 15a(3) of the Act and this Court's construction of that provision in the *New Haven case, supra*, in first determining and then preserving inherent transportation advantage and, secondly, whether the report of the Commission is erroneous as a matter of law for failing to state a rational basis for its decision as found by the District Court.

In substantial part the District Court's erroneous interpretation of the governing statutory provisions lies in its failure to recognize the nature of the change wrought by Section 15a(3), enacted in the Transportation Act of 1958. As this Court observed in discussing the legislative history of that provision in the *New Haven case*, the Commission, somewhat like a "giant handicapper," had frequently struck down rate proposals in order to protect the traffic of another mode of transportation irrespective of whether the latter mode was the more efficient. As will be demonstrated, *infra*, this artificial protective policy was all that was involved in the *New Automobiles case*. (*New Automobiles in Interstate Commerce*, 259 I.C.C. 475), upon which the District Court erroneously relies.

The railroads in urging the so-called "three shall-nots" upon the Congress, to which this Court referred in the *New Haven case*, (372 U.S. at 753) would have denied the Commission the power to "consider [1] the effect of such [proposed rate] charge on the traffic of any other mode of transportation; or [2] the relation of such charge to the charge of any other mode of transportation; or [3] whether such charge is lower than necessary to meet the competition of any other mode of transportation * * *." As this Court found, the "three shall-nots" were "explicitly rejected." Had they been enacted, of course, the District Court in this proceeding might soundly have held, as it did here, that the power and, hence the inquiry,

of the Commission should cease with a determination of whether the proposed rate exceeds the out-of-pocket costs of the proponent mode, but that was not the case. The Commission interpreted, and it is submitted properly, the legislation as it was in fact enacted by the Congress.

Moreover, in concluding, as did the District Court, that the Commission's rationale in preserving a demonstrated inherent cost advantage "is directly in conflict with the conclusion of the Supreme Court in *New Haven*. (See our last above quote of the Court from that case)," (268 F.Supp. at 79, App. 14) the court below ignored a very significant word in the sentence quoted from this Court's opinion in *New Haven*. This Court said there that "if a carrier is prohibited from establishing a reduced rate that is not detrimental to its own revenue requirements *merely* because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service." (372 U.S. at 759) (Emphasis added.) In this instance not only are the railroads not thwarted from asserting their inherent advantages, since the advantage was here found to lie with the barge-truck route, but there is no basis for any suggestion that the Commission's order herein was adopted "*merely*" to protect the barge-truck route from diversion of its traffic. To the contrary, it was invoked expressly to preserve the demonstrated inherent advantage of the lower cost barge-truck service. Hence, the *New Automobile* decision, relied upon by the court below, is clearly distinguishable.

The District Court's interpretation of Section 15a(3), in effect, enacted the "three shall-nots" which the Congress rejected, and thereby overruled the Commission's valid interpretation of its powers recited in its report. To conclude, as does the court below, that Congress intended that "carriers should normally be free to offer rates which are compensatory" (268 F.Supp. at 82, App.

20) is to attribute to the Congress a meaningless act in enacting Section 15a(3) of the Act. If that provision means only that the Commission's power thereunder, expressly required to be interpreted and exercised in light of the mandates of the National Transportation Policy, is limited to condemning non-compensatory rates, that is, those below out-of-pocket costs, Section 15a(3) would merely be duplicative of the powers long since conferred upon the Commission by Sections 1 and 15a(2) of the Act.

The change in fact effected by Section 15a(3) was to require carriers seeking protection from competitive rate making by other modes of transportation to henceforth prove their entitlement to such protection by demonstrating that, on the subject traffic, they are the inherent advantage, lower-cost mode of transportation. Whether the test to be employed in that determination be fully distributed costs, out-of-pocket costs, or some other measure, as this Court indicated in *New Haven*, is immaterial to the existence of the Commission's *power* to make a comparison of the competing modes to identify the inherent advantage mode and, upon the basis of that comparison, to take appropriate action to protect that mode against impairment of its inherent advantage by the rate action of the other mode. A substantial question here presented is the finding of the District Court that the Commission, upon interpreting the pertinent statutory provisions, erred in concluding that it possesses this power. Resolution of this question is not only of transcendent importance to the barge line industry, here faced with the prospect of a deluge of diversionary railroad rate proposals, but also to the public generally which heretofore has looked to the Commission to preserve and foster efficient low cost transportation by all modes as required by the National Transportation Policy.

B. The Basis For The Commission's Use Of Full Costs As The Measure Of Inherent Advantage.

The second substantial issue here presented is the holding of the District Court that "the Commission has failed to state a rational basis to support its selection of the "fully distributed" costs of the barge-truck mode as the floor for reduced rail rates. In reaching this conclusion the court below has ignored both the clear-cut findings of the Commission and the guide lines for consideration of the issue laid down by this Court in *New Haven* and followed by the Commission. In that case this Court twice recognized that the typical situation contemplated by the Congress in enacting Section 15(a)(3) is that of a railroad establishing a compensatory rate below its fully distributed cost and thereby forcing a lower cost competitor to establish an unprofitable rate or perhaps go out of business. (372 U.S. at 758, 759) This was precisely the factual situation in the *Ingot Molds ease* and the result which the Commission properly took steps to prevent.

The basis for the Commission's decision must be viewed in the light of its many prior reports affirming the validity of full costs as the measure of inherent advantage and upon consideration of both its report and that of Division 2. The report of the Commission gave full consideration to the testimony of the four economists testifying for the railroads. That report expressly incorporated the prior findings of Division 2 on this subject wherein the railroads' incremental cost theory was discussed and rejected. (326 I.C.C. at 77, App. 50) Division 2, finding that "For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the nation's transportation system is to be healthy" stated that it *adhered* "to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost." (323 I.C.C. at 762, 763, App. 29-30) The stated basis for rejecting the use

of out-of-pocket or incremental costs is that the suggested measure of inherent advantage "ignores" the "existence of constant costs." (323 I.C.C. at 763, App. 30)

The Commission, in its report, quoting from the Division's conclusion adhering to the full cost standard stated "We agree." (326 I.C.C. at 81, App. 55) Applying the full cost standard to the rates before it, the Commission went on to find, just as in the example used by this Court in *New Haven*, that the railroads' rate, below the full costs of the barge-truck mode, "unlawfully impinged upon the latter's ability "to assert its inherent cost advantage" and would, if unchecked, "deprive shippers of cheaper water transportation." (326 I.C.C. at 85, App. 60)* Certainly, this is the Commission's function under the National Transportation Policy. It might also be noted that the rationale here reiterated by the Commission is that previously and more inflexibly espoused by the Department of Justice in the *New Haven case* where it urged upon brief to this Court that an inherent cost advantage is impaired "when the low cost carrier is unable to fix a rate which (a) covers its fully-distributed costs and (b) affords it a rate advantage (as against the high cost carrier) which is no less than the cost differential (measured in terms of fully distirbuted cost) between the modes." (See brief of United States before the District Court, p. 45.)

It is submitted, therefore, that the Commission has stated the rational reasons for its decision consistent with the requirements of administrative due process. The adequacy of these findings is clearly a substantial question for consideration by this Court.

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* Attention is directed to the preliminary discussion at 326 I.C.C. 82 (App. 57) whereat the Commission recognized the vulnerability of barge traffic to selective railroad competition because of the greater dependence of the former upon a limited number of commodities.

CONCLUSION

For the reasons heretofore stated, appellants believe that the questions submitted by this appeal are substantial and are of such far-reaching public importance as to require plenary consideration by this Court, with briefs on the merits and oral argument, for their resolution.

Respectfully submitted,

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APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

Civil Action No. 5227

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and
THE PENNSYLVANIA RAILROAD COMPANY,
Plaintiffs

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION,
Defendants.

Before the Honorable Harry Phillips, Circuit Judge, and the Honorable Henry L. Brooks and the Honorable James F. Gordon, District Judges.

OPINION

Gordon, District Judge. This suit was brought before this Three-Judge Court, under the provisions of 28 U.S.C. §§ 1336, 2284, 2321-2325, by the Louisville and Nashville Railroad Company and The Pennsylvania Railroad Company to enjoin, annul and set aside an order of the Interstate Commerce Commission in Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965). As required by law, the United States of America was named a defendant, as was the Interstate Commerce Commission.

Some 48 railroads were permitted to intervene as additional plaintiffs in support of the principal plaintiff railroads. Interested and requesting barge lines, truck carriers and related associations were permitted to inter-

vene in support of the defendant, Interstate Commerce Commission.

The United States of America, admitting that "the Order of the Interstate Commerce Commission is invalid", was, for purposes of brief and oral argument, treated as an additional plaintiff.

On January 23, 1967, oral argument was heard before this Court.

In 1953, the Green River Steel Corporation began purchasing ingot molds and stools from the Shenango Penn Mold Company at Neville Island, Pittsburgh, Pa. The shipper's plant at Neville Island is served by the Pennsylvania Railroad in connection with a short-line railroad, and the receiver's plant at Steelton, Kentucky is served directly by the Louisville and Nashville Railroad. Prior to 1965 the barge-truck route received substantially all of this traffic because its charges were below rail charges. The then and present charge for movement by barge-truck being $5.11 per gross ton, minimum 600 gross tons, and the railroad charge then being $11.86 per ton, subject to a carload minimum of 100,000 pounds.

With the stated purpose of enabling them to compete for this traffic, the respondent railroads published, effective December 1, 1963, a reduced rate on ingot molds, from Neville Island and Pittsburgh, Pa., to Steelton, Ky., of $5.11 per ton, when moved in single shipments of not less than 600 gross tons, minimum weight 112,000 pounds per car (12 or fewer cars) on one bill of lading, from one consignor at one origin to one consignee at one destination, with delivery to the originating railroad to be completed on one day. Consignee testimony indicates that if the railroads are to participate substantially in the movement, it will be necessary to have a rail rate not exceeding the total cost to the consignee of handling the ingot molds via barge-motor service.

The Commission found that the railroads' so-called out-of-pocket costs of transporting the ingot molds traffic, when computed by its own Rail Form A formula, would be $4.689 per ton, and substantially less if return on investment were eliminated. Since the reduced rail rate exceeded such costs by 42.1 cents, the Commission found that the rate would be compensatory. The Commission further found that the lower rail rate of $5.11, by attracting greater volume, would produce greater revenues in excess of out-of-pocket costs than would the higher rail rate of $11.86, which formerly had attracted only minimal tonnage, and also that "the railroad out-of-pocket costs are lower than the barge-motor lines' variable (i.e., out-of-pocket) costs". Further, that the railroads' "fully-distributed" costs amounted to $7.594 and the barge-truck "fully-distributed" costs were $5.196. These "fully-distributed" cost calculations were made by adding to the expenses incurred in handling the ingot molds traffic statistical apportionments of the respective modes' constant costs. The constant costs are expenses which are not related or traceable to the handling of any particular item of traffic.

Upon protest of the barge lines, the reduced rail rate was suspended and placed under investigation by the Commission. By voluntary agreement, the suspension period was extended until the matter was determined by Division 2. After Division 2, on February 17, 1965, 323 I.C.C. 758, found the rate to be lawful, the railroads made it effective on March 19, 1965. This rate has remained in effect since that time. Subsequently, December 2, 1965, the entire Commission in its report and order found the rate to be unlawful and ordered it cancelled, 326 I.C.C. 77, but this order of the Commission has been stayed pending consideration of the situation by this Court.

The Commission held that the determination of which mode had the inherent advantage of lower costs in han-

dling the involved ingot molds traffic should be based upon a comparison of the "fully-distributed" costs of the two modes. Upon this comparison, it found that the barge-truck route possessed the advantage of lower costs in transporting ingot molds. It further decided that the reduced rail rate unlawfully "impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage" because the reduced rate was below the level of the "fully-distributed" costs of the barge-truck route. The Commission established the "fully-distributed" costs of the barge-truck route ($5.196) as the floor for the reduced rail rate, although the barge-truck rate of $5.11 was below this level.

The principal statutory provision governing this controversy is Section 15a(3) of the Interstate Commerce Act (49 U.S.C. § 15a(3)), which came into the Act by the enactment of the Transportation Act of 1958, 72 Stat. 572. That Section reads:

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

The National Transportation Policy referred to is the preamble to the Interstate Commerce Act and provides guidance for interpreting the various sections of the Act. In its present form, it became part of the Interstate Commerce Act by the enactment of the Transportation Act of 1940, 54 Stat. 898. It reads:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating and preserving a national transportation system by water, highway and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

Jurisdiction of the subject matter and venue of this action in this Court is conceded by the parties.

Under Section 10(e) of the Administrative Procedure Act, 5 U.S.C. § 1009, the scope of our review of the Commission's order is limited to a determination of whether the order is arbitrary or not in accordance with the law, and whether the Commission's findings are supported by substantial evidence. An order is arbitrary within the meaning of the Administrative Procedure Act if it lacks a stated rational basis. See *Gilbertsville Trucking Co.* v. *United States*, 371 U.S. 115, 126 (1962); *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 167-68 (1962); *Eastern Central Motor Carriers Ass'n* v. *United States*, 239 F.Supp. 591, 594 (D. D.C. 1965). It is not in

accordance with the law within the meaning of Section 10(e) if it is based upon an erroneous interpretation or misapplication of relevant statutory provisions. See *St. Louis-San Francisco Ry. Co.* v. *United States*, 207 F.Supp. 293, 295 (E.D. Mo. 1962); *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 631-33 (E.D. Mo. 1962). While the determinations of an administrative agency are normally entitled to considerable deference upon review, *cf. East Texas Lines* v. *Frozen Food Express*, 351 U.S. 49, 54 (1956), and orders of the Commission which satisfy the requirements stated above are not to be disturbed on review even though the Court might reach a different result on the record, "it is not the function of a court sitting in such review merely to apply a rubber stamp of approval regardless of whether or not the criteria for affirmance are established by the record". *Cincinnati, N.O. & T.P. Ry. Co.* v. *United States*, 229 F.Supp. 572, 575 (S.D. Ohio 1964), vacated *sub. nom. Arrow Transp. Co.* v. *Cincinnati, N.O. & T.P. Ry. Co.*, 379 U.S. 642 (1965).

We have concluded that the Commission's order must be set aside, *first*, because it lacks a rational basis and thus is arbitrary and, *second*, because it is inconsistent with the objectives and purposes of Congress in enacting Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. § 15a(3), and thus is not in accordance with law.

In disapproving the proposed reduced rate of the railroads, the Commission appears to us to be plainly holding up the railroad rate "to protect the traffic" of another mode. It argues, however, that the National Transportation Policy, to which it is commanded to give "due consideration" by the same provision, compels this result. It relies specifically on the requirement that the Act be administered to "recognize and preserve the inherent advantages of each (mode of transportation)".

In *Interstate Commerce Comm'n* v. *New York, N.H. & H.R.R. Co.*, 372 U.S. 744, 760-61 (1963) (referred to hereafter as *New Haven*), the Supreme Court specifically left open the question which is raised in this proceeding. The Court said:

> It is not for us to make this determination at this stage or to decide in advance precisely how either carrier's inherent advantages should be measured or protected. It may be, for example, that neither a comparison of 'out-of-pocket' nor a comparison of 'fully-distributed' costs, as those terms are defined by the Commission, is the appropriate method of deciding which of two competing modes has the cost advantage on a given movement . . . . These and other similar questions should be left for initial resolution to the Commission's informed judgment. (372 U.S. at 760-61)

This is the first case following *New Haven* in which a court has been called upon to review a determination by the Commission of how the inherent advantages of competing modes of transportation should be recognized or preserved. Since there are no directly controlling court precedents, it is for this court to determine whether the Commission's order properly implements the objectives and purposes of the Congress in enacting Section 15a(3).

We hold, first, that the Commission has failed to state a rational basis to support its conclusion that the "fully-distributed" costs of the two competing modes must be compared to determine which mode has an inherent cost advantage. In support of this conclusion, the Commission states:

> We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for

> transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, *does not necessarily mean that the carrier is the more efficient of the two.* Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve. (326 I.C.C. at 82) (Emphasis added)

The language we have just quoted contains the only statement in the Commission's opinion in which it refers to the question of the relative efficiency of the competing carriers in carrying this traffic. This question is one of great importance in view of the Commission's obligation, declared in the National Transportation Policy and the ratemaking provisions of the Act, to promote efficient and economical use of transportation resources and the establishment of rates which are as low as possible. The importance of these considerations has been underscored repeatedly by the courts. Thus, the Supreme Court in *New Haven* emphasized the Congressional policy to promote "hard competition" (372 U.S. at 759). In *St. Louis-San Francisco Ry. Co.* v. *United States*, 207 F.Supp. 293, 298-99 (E.D. Mo. 1962), the court emphasized the obligation of the Commission to consider "the need, in the public interest, of adequate and efficient transportation service at the lowest cost consistent with the furnishing of such service".

The Commission states that: "Merely because a carrier is able, without incurring an out-of-pocket loss, to handle

certain traffic at rates below fully-distributed costs and by gaining added traffic maximize the contribution which such traffic makes to its overhead, does not necessarily mean that the carrier is the more efficient of the two" (326 I.C.C. at 82). Are we not entitled to ask *in what circumstances*, if any, would the carrier with lower out-of-pocket costs be *less efficient*? Are we not entitled to some explanation *why the standard* chosen by the Commission *measures* which carrier is more efficient in providing the service here involved? On the basis of the Commission's report, we are left completely in the dark on these matters.

The Commission's failure to explain how its approach for recognizing and preserving the inherent advantages of the different modes of transportation promotes the most efficient and economical use of transportation resources is particularly wanting since the record before it contained testimony addressed to this question; though the Commission was not bound to accept same, such did at least, we think, make it necessary for the Commission to set forth adequate reasons to support its own approach. Such reasons are lacking in the Commission's report.

For example, the record indicates that one of the constant expenses which is included in the railroads' "fully-distributed" costs is an allocated share of the deficits (very substantial in amount) incurred by the railroads in providing passenger and less-than-carload services.

The barge lines and motor freight carriers do not provide passenger services. Is it unrealistic in comparing the relative efficiency of the two modes, to include as a part of the railroads' costs these deficits? Is it equally unrealistic in determining which mode is more efficient, to include any other constant expenses in the costs being compared, since these expenses, like the passenger deficits,

are not related to furnishing the particular service? The Commission no where comes to grips with these questions, nor does it set forth its own analysis in making its determination.

In its statement supporting its conclusion hereinabove, the Commission also says that, "In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs." This statement reflects the Commission's use of an out-of-pocket cost comparison to determine which of the competing modes has an inherent advantage in situations where there is substantial competition from unregulated carriers. In such situations, the Commission finds a reduction lawful if it exceeds the proponent carrier's out-of-pocket costs. See *Grain in Multiple-Car Shipments—River Crossings to the South*, 321 I.C.C. 582 (1963).

The Commission leaves unexplained its use of different pricing floors *depending upon whether a reduced rate* is intended to meet *regulated* or *unregulated* competition.

We believe that the reasons given by the Commission in the Southern Grain case to support its conclusion that the public interest is fostered by permitting a regulated mode to compete with nonregulated lawful carriers, by offering reduced rates which exceed out-of-pocket costs, logically would seem to apply equally where competition is between two competing regulated modes.

Likewise, we reject as adequate support for the Commission's decision here, its finding that since railroad out-of-pocket costs are lower than barge-motor line variable costs, the former could wage a longer rate battle than the latter, with the Commission powerless to intercede and halt such devastation, all to the prejudice of recognition and preservation of inherent advantage as contemplated

by national policy. The Commission's power to disapprove non-compensatory rates and prevent destructive competition is firmly established. Such an argument that the consequence of a rate reduction below fully distributed costs would leave the Commission powerless has heretofore been rejected. *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 635 (E.D. Mo. 1962).

Citations by the Commission of several prior decisions in which it compared "fully-distributed" costs to determine which mode had an inherent advantage contain no further explanation to support such a standard, although not determinative, we note that the Commission has not consistently employed a "fully-distributed" cost standard. For example, in one recent case, *Roasted Coffee and Coffee Extracts From Texas Gulf Ports to Texas*, 314 I.C.C. 675, 680 (1961), the Commission says, "It would be inconsistent with the national transportation policy to prohibit the respondents from establishing competitively necessary rates which are shown to be compensatory." And see *Paint and Related Articles in Official Territory*, 308 I.C.C. 439 (1959); *Fresh Meats, Transcontinental, Westbound*, 309 I.C.C. 529, 544 (1960); *Prue Motor Transp. Inc.* v. *Boston & Maine R.R.*, 316 I.C.C. 299, 302 (1962). *Cf. Iron Ore, Cleveland, Ohio to Ohio and Pennsylvania*, 323 I.C.C. 746, 754 (1965), complaint dismissed, *Baltimore & Ohio R.R. Co.* v. *United States*, 249 F.Supp. 712 (W.D. Pa. 1965), aff'd *per curiam* 385 U.S. 3 (1966).

The Commission also relies upon the decision of the Supreme Court in *New Haven*. We have previously pointed out that the Supreme Court there specifically left open for later decision the question which is presented in this proceeding, after making it clear that this question was not before it (372 U.S. at 749-50). As we read the Supreme Court's opinion, it held that the Commission

cannot, under Section 15a(3) and the National Transportation Policy, find unlawful the reduced rate of one mode merely because it would divert some or even all of the traffic from a competing mode. As the Court said:

> If there is one fact that stands out in bold relief in the legislative history of § 15a(3), it is that Congress did not regard the setting of a rate at a particular level as constituting an unfair or destructive competitive practice simply because that rate would divert some or all of the traffic from a competing mode. (372 U.S. at 759)

The Court also said that a reduced compensatory rate should not be found unlawful unless this is necessary to preserve the inherent advantages of a competing mode (372 U.S. at 758). And it added:

> If a carrier is prohibited from establishing a reduced rate that is not detrimental to its own revenue requirements merely because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service. (372 U.S. at 759)

We note that in the situation before us the Commission found not only that the reduced rail rate would be compensatory, but that it would produce greater revenues in excess of out-of-pocket costs than would the former higher rate. The reduced rate therefore will not be detrimental to the railroads' revenue requirements. In these circumstances and in light of the inadequacy of the Commission's report with respect to the recognition and preservation of inherent advantages, we are of the belief that *New Haven* provides no support for the Commission's order.

We also hold that the Commission has failed to state a rational basis to support its selection of the "fully-

distributed" costs of the barge-truck mode as the floor for reduced railroad rates. The Commission said:

> In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. Cf. *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567, 575-579 (1947); *Dixie Carriers, Inc.* v. *United States*, 351 U.S. 56 (1956). (326 I.C.C. at 85)

How does the reduced railroad rate deprive shippers of cheaper water transportation? It appears to us to only provide shippers with an alternative form of transportation at an equivalent rate. The decisions cited by the Commission furnish no support for its conclusion, since none was concerned with Section 15a(3) or the setting of minimum rate floors. In *Mechling*, railroads carrying grain from Chicago to Eastern cities were charging more for carrying grain which arrived in Chicago by water carrier than for grain which arrived by rail. The Supreme Court upheld the Commission in finding that this action discriminating against water carriers violated § 3(4) of the Act. In *Dixie Carriers*, the railroads had refused to establish a joint rail-barge rate between two points in Texas. The Supreme Court held that this refusal constituted a discrimination in rates between connecting lines prohibited by § 3(4) of the Interstate Commerce Act, and that the Commission had a duty under § 307(d) to establish through routes and joint rates for rail-barge transportation. No such issue of discrimination is presented here.

We cannot escape the conclusion that the ultimate finding that the rates in issue are not just and reasonable

was motivated by the Commission's desire to prevent any rate competition which threatens the continued existence of a competitor. In support of its determination to employ a comparison of "fully-distributed" costs to determine which mode possesses an inherent advantage, the Commission stated its belief that "an inherent cost advantage under the National Transportation Policy reasonably could not embrace a concept that would impair the ability of a carrier not only to compete but to exist" (326 I.C.C. at 82). This rationale is directly in conflict with the conclusion of the Supreme Court in *New Haven*. (See our last above quote of the Court from that case.)

It is our belief that the Commission's order is based upon a misinterpretation or misapplication of the relevant statutory provisions. We gain support from the legislation itself, its history, and its application in other recent cases. In *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 633 (E.D. Mo. 1962), a three-judge District Court stated:

> "As far back as 1945, in the case of New Automobiles in Interstate Commerce, 259 I.C.C. 475, the Commission had said, l. c. 538:
>
> > 'As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, *there appears to be no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa.*' (Emphasis added)
>
> In spite of these words, the Commission had, in a line of cases through the early 1950's, often canceled reduced rates, though they were fully compensatory.

> While the Commission has traditionally contended that such cancellations were not ordered to protect other modes, the Congress felt otherwise, and enacted Section 15a(3) at least in part as a direction to the Commission to treat competitive rate cases in a manner consistent with the language and spirit of New Automobiles."

We do not think there can be any doubt that the underlying purpose of Congress in enacting Section 15a (3) was to direct the Interstate Commerce Commission to observe the original intent of Congress in 1940 and to restore and adhere to the policy set forth in *New Automobiles* with respect to the preservation of inherent advantages. Both the Senate and House Committee Reports are explicit on this matter,[1] and there were also

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[1] The Senate Report, after stating it "agrees with and wishes to emphasize the import of" the Senate Subcommittee report, quotes the following from it:

> It nevertheless appears that the Interstate Commerce Commission has not been consistent in the past in allowing one or another of the several modes of transportation to assert their inherent advantages in the making of rates. The subcommittee recommends, therefore, that the Commission consistently follow the prinpicle of allowing each mode of transportation to assert its inherent advantages, whether they be of service or of cost. In 1945 in New Automobiles in Interstate Commerce (259 I.C.C. 475), the subcommittee believes that the Commission properly construed the intent of Congress in this respect when it said:
>
> > 'As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, there appears no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa' (259 I.C.C. at p. 238).
>
> The subcommittee wishes to affirm the interpretation of the Commission given in the Automobile case epitomized in the words quoted above. The subcommittee therefore believes it

repeated statements of such an intent in the hearings and debates on Section 15a(3).[2] See *Interstate Commerce Comm'n* v. *New York, N.H. & H. R.R. Co.*, 372 U.S. 744, 755-56 (1963).

There are indications that Congress believed the National Transportation Policy would not prevent carriers from establishing rates which exceeded out-of-pocket costs in the kind of situation here presented. For example, Congressman Wolverton, who was a member of the House Commerce Committee, which reported the bill, said that: "If each mode of transportation is permitted to have rates not below a compensatory figure so that competition can really exist, I think you are then preserving the rights, the inherent rights of each."[3] Congressman O'Hara, another member of the House Commerce Committee, stated that: "If [one] mode of transportation has a compensatory rate and it is lower than that of the competitor, the Interstate Commerce Commission would have to allow [it] to charge a lower rate." (104 Cong. Rec. 12536)[4] A list of "Decisions of the Interstate Com-

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necessary to amend the act only so as, in effect, to admonish the Commission to be consistent in following the policy enunciated in the Automobile case thus assuring reasonable freedom in the making of competitive rates.

The subcommittee anticipates that the broad effect of this amendment will be to encourage competition between the different modes of transportation to the benefit of the shipping public. S. Rep. No. 1647, 85th Cong., 2d Sess., pp. 2-3.

The House Report is to the same effect. H. Rep. No. 1922, 85th Cong., 2d Sess., p. 14.

[2] See, *e.g.*, 104 Cong. Rec. 10842, 12531, 12532; Hearings on S. 3778 before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 14, 29, 178.

[3] Hearings on Railroad Problems Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., p. 409.

[4] Senators Schoeppel, Lausche and Smathers likewise indicated that compensatory rates should normally be permitted. Hearings

merce Commission in Which the Policy of the New Automobiles Case Has Not Been Followed", which was before Congress in 1958, likewise makes it plain that Congress was concerned about cases in which the Commission had declared reduced rates unlawful, although finding that they were compensatory. See Hearings on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 86-91, 174-175.

In a more general vein, the Committees reporting on the bill emphasized that the chief thrust of the amendment was to encourage competitive ratemaking among the different modes of carriage. The Report of the Senate Committee on Interstate and Foreign Commerce described Section 15a(3) as "designed to encourage competition * * * by allowing each form of transportation * * * full opportunity to make rates reflecting the inherent advantages each has to offer * * *" and it expressed approval of the following language of the Supreme Court in *Schaffer Transportation Co.* v. *United States*, 355 U.S. 83 (1957):

> The ability of one mode of transportation to operate with a rate lower than competing types of transportation is precisely the sort of 'inherent advantage' that the congressional policy requires the Commission to recognize.

S. Rep. No. 1647, 85th Cong., 2d Sess., p. 3; and see H. Rep. Co. 1922, 85th Cong., 2d Sess., pp. 13-15.

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on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 11, 56 and 111. Moreover, we note that Congress specifically rejected a provision which would have prevented carriers from offering rates below fully-distributed costs in cases of inter-modal competition. Senator Lausche indicated that the proposal, if adopted, "would completely negative the purposes and intent of the Congress in 1940 and in 1953 when it declared that the inherent advantages of each mode of transportation shall be preserved in the interest of the public". Hearings on S. 3778, *supra*, p. 26.

We observe that the specific Congressional mandate in 1958 was that the Commission *should henceforth be bound in establishing minimum rates by the original intent of Congress in 1940* and the decision of the Commission in *New Automobiles*. In *New Automobiles* the Commission conducted a general investigation of all rates subject to its jurisdiction applying to the transportation of new automobiles, including rates of various forms of rail, truck and water carriage. The motor carriers, who initiated the proceeding, alleged that rail reductions made on an out-of-pocket basis would deprive them of their inherent advantages which the Commission was obligated to preserve by the terms of the National Transportation Policy (259 I.C.C. 539), and asked the Commission "to lay down the principle that in meeting highway competition the railroads should in no instance go below the fully-distributed rail costs or the truck rates". (259 I.C.C. 530). The railroads, on the other hand, asked that they be left free to meet competition by reducing rates to whatever level was necessary in order to attract traffic, provided their rates exceeded out-of-pocket costs (*Id.* at 532-33).

In determining "the relative fitness of the various agencies of transportation" from a cost standpoint, the Commission there compared the railroads' out-of-pocket costs with the truck "full" costs, after finding that the truck "full" costs were substantially the same as its out-of-pocket costs (259 I.C.C. at 529). Upon this comparison, which essentially was of the two modes' out-of-pocket costs, the Commission found that for shorter distances the motor carriers were the low-cost agency, while for the longer distances the cost advantage was with the railroads. Finding that, "According to the cost studies the rates of the several forms are generally compensatory, except in scattered instances", it held that the rates exceeded a "reasonable minimum level" and were lawful. It defined a compensatory rate as "one which is re-

munerative, i.e., covers the out-of-pocket costs, as hereinbefore defined, of handling the particular traffic under consideration, including a proper return on investment".

Noting that "within reasonable limits the public is entitled to the reduced rates brought by competition", the Commission indicated that its decision carried out the intent of Congress.

Thus, in *New Automobiles*, the Commission indicated its understanding that Congress intended that carriers should normally be free to offer rates which were compensatory. This construction of the National Transportation Policy is clearly supported by the legislative history of the Transportation Act of 1940. Congress not only rejected all proposals which would have prevented carriers from offering compensatory rates which were below fully-distributed costs, including the so-called Miller-Wadsworth amendment,[5] but in so doing it made

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[5] The so-called Miller-Wadsworth amendment to the minimum rate section would have provided:

> In order that the public at large may enjoy the benefit and economy afforded by each type of transportation, the Commission shall permit each type of carrier or carriers to reduce rates so long as such rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all other elements entering into the cost to the carrier or carries for the services rendered. (84 Cong. Rec. 6074)

This amendment was included in the bills originally passed by the Senate and the House (84 Cong. Rec. 6074, 9962, 9977), but the Joint Conference Committee of the Senate and the House, to whom these bills were referred, eliminated it. Following lengthy debate, particularly in the House, as to whether it should be restored, ultimately both the Senate and the House voted not to restore it (86 Cong. Rec. 10193-94, 11766-67). Various other proposals which were advanced to prohibit rates below fully-distributed costs in inter-modal competitive situations were also rejected. See H.R. 2531, 76th Cong., 1st Sess., sec. 41; Hearings on S. 1310 and S. 2016, S. 1869 and S. 2009 Before the Senate Committee on Interstate Commerce, 76th Cong., 1st Sess., p. 698.

> . . . It is unnecessary that each individual rate, in order to be profitable, must bear its full share of all costs, including over-

known its belief that such a restriction on competition would be extremely undesirable both from the standpoint of shippers and from the standpoint of the general public seeking the most efficient use of transportation resources.

For example, in explaining why the Miller-Wadsworth amendment was rejected, Congressman Wolverton, one of the managers of the bill in the House and a House conferee as well as a member of the House Commerce Committee, stated:

> The amendment would not only slow up and seriously hamper all reductions but would absolutely prevent a great many desirable reductions from being made.

We believe that the Commission failed to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs. Moreover, we think the Commission's decision here is inconsistent with its philosophy in *New Automobiles*. The Commission's order is therefore not in accordance with law.

We do not mean to suggest that there may not be situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory. What we do suggest is that Congress has expressed a clear intent that reduced compensatory rates should normally

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head, and produce a reasonable profit above such costs. If a rate is high enough to pay more than out-of-pocket operating expenses, it helps meet some of the constant overhead.

. . . We should do nothing that will unnecessarily prevent or delay rate reductions; strike a blow at the fundamental principle of rate making upon which this country was developed, and obstruct, or hinder the free flow of commerce which is so essential to our economic welfare. (86 Cong. Rec. 10190-91)

And see 84 Cong. Rec. 9963, 9970; 86 Cong. Rec. 10179, 10187, 11766-67.

be allowed and that the record here and the Commission's report supply no basic for disregarding that intent.

For the foregoing reasons, the order of the Commission in *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965), is hereby set aside and permanently enjoined and the matter is remanded to the Commission for action not inconsistent with this opinion.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

Civil Action No. 5227

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and
THE PENNSYLVANIA RAILROAD COMPANY,
Plaintiffs,

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION,
Defendants.

JUDGMENT

This cause having been heard on the plaintiffs' complaint seeking to enjoin, set aside and annul a report and order of the Interstate Commerce Commission, dated December 2, 1965, in a proceeding styled Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965); and the parties appearing by counsel having been heard and the issues duly tried; and the Court having concluded in its opinion that plaintiffs are entitled to judgment:

It is hereby Ordered, Adjudged and Decreed that the above described report and order of the Interstate Commerce Commission, entered December 2, 1965, be set aside and the Interstate Commerce Commission is hereby enjoined from enforcing it with prejudice. The matter is remanded to the Commission for reconsideration and such further action as the Commission may deem appropriate, not inconsistent with the opinion this day rendered by this court.

Issued at Louisville, Kentucky, this 15th day of May, 1967.

/s/ Harry Phillips
HARRY PHILLIPS
United States Circuit Judge

/s/ Henry L. Brooks
HENRY L. BROOKS
United States District Judge

/s/ James F. Gordon
JAMES F. GORDON
United States District Judge

A Copy: Attest

MARTIN R. GLENN, Clerk

By /s/ Loraine Milly
Deputy Clerk

APPENDIX C

Investigation and Suspension Docket No. 8038

INGOT MOLDS, PA., TO STEELTON, KY.

Decided February 2, 1965

Proposed multiple-car rate, minimum 600 gross tons, on ingot molds and ingot mold stools from Neville Island and Pittsburgh, Pa., to Steelton, Ky., found just, reasonable, and otherwise lawful. Proceeding discontinued.

Carl Helmetag, Jr., and *E. R. Leigh* for respondents.

Harry C. Ames and *Wesley A. Rogers* for protestants.

REPORT AND ORDER OF THE COMMISSION

DIVISION 2, COMMISSIONERS FREAS, TUCKER AND TIERNEY

FREAS, *Commissioner:*

By schedules filed to become effective on December 1, 1963, the respondent railroads[1] proposed to establish a reduced rate[2] on ingot molds and ingot mold stools,[3] both herein called ingot molds, from Neville Island and Pitts-

[1] The Pennsylvania Railroad Company and the Louisville and Nashville Railroad Company, hereinafter called the Pennsylvania and the L. & N., respectively.

[2] Rates, differences in rates, costs, and charges are stated per gross ton of 2,240 pounds, unless otherwise indicated.

[3] An ingot mold is a cast-iron form in which molton steel is cast in making ingots. The stool is the base upon which open-bottom molds stand.

burgh, Pa., to Steelton, Ky., of $5.11 when moved in single shipments of not less than 600 gross tons, minimum 112,000 pounds per car (12 or fewer cars), on one bill of lading, from one consignor at one origin to one consignee at one destination, with delivery to the originating railroad to be completed on one day. Upon protest of the Waterways Freight Bureau, the operation of the schedules was suspended to and including June 30, 1964, and an investigation was instituted. The effective date of the schedules has been voluntarily postponed to and including March 31, 1965. Evidence was submitted at the hearing by the respondents in support of the proposed rate, and in opposition thereto by the aforementioned bureau and certain of its members,[4] collectively called protestants. Due and timely execution of our functions under section 15(7) of the Interstate Commerce Act imperatively requires the omission of recommended report and order in this proceeding.

The ingot molds involved herein move principally by barge in connection with truck delivery from the producing plant of the Shenango Perm Mold Company at Neville Island, located in the Pittsburgh port area, to the Green River Steel Corporation at Steelton, 3.5 miles from the Owensboro, Ky., river-rail terminal where barge facilities are located. The shipper's plant is served by the Pennsylvania in connection with the short-line railroad, the Pittsburgh, Chartiers & Youghiogheny Railway Company, hereinafter referred to as the P. C. & Y., and the receiver's plant is served directly by the L. & N.

The proposed rate of $5.11 is equal to the overall charges to the receiver for the barge movement. The latter consist of a barge rate of $3.32, minimum 600 gross tons, a barge-to-truck transfer charge of 95 cents

[4] Mississippi Valley Barge Line Company, Ohio River Company, and Union Barge Line Company.

at Owensboro, and the for-hire truck charge of 84 cents for the movement from Owensboro to Steelton. The present rail rate is $11.86,[5] subject to a carload minimum of 100,000 pounds.

From 1953, following the completion of the receiver's plant at Steelton, to the present time, the movement has been almost exclusively by barge. From 1953 to 1963, the barge rates have increased from $2.84 to $3.32, and the minimum has increased from 500 to 600 gross tons. Notwithstanding the increased minimum weight and rate, net tonnages of 3,878, 4,320, and 5,017 in 1961, 1962, and 1963, respectively, indicate a steady rise in the volume of this traffic moving by barge in recent years. During the first 3 months of 1964, the barge tonnage was 1,500. Barge shipments, on the average, exceed 600 tons. Analysis of systemwide revenues for bureau members for 1962 indicates that iron and steel, which includes class 579 in which the carriers report ingot molds for statistical purposes, is the third most important commodity group transported in barge service, accounting for 10.81 percent of total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of total barge traffic.

In 1953, the rail rate was $13.50, minimum 50,000 pounds. In 1958, it reached a high of $16.72, same minimum, before it was reduced to $12.52, minimum 100,000 pounds. Subsequently, it was reduced to the present rate of $11.86.

The stated purpose of the instant proposal is to enable the respondents to compete for this traffic. Rail shipments have been limited to isolated instances when the receiver's production schedules have required special orders of certain kinds of ingot molds. For example, in 1962 the railroads moved two shipments aggregating 112

[5] This is a conversion of the rate per net ton of $10.59, shown in the tariff, to a gross-ton basis.

net tons; in 1963, five shipments aggregating 276 net tons; and during the first 3 months of 1964, two shipments aggregating 116 net tons. Consignee testimony indicates that if the railroads are to participate substantially in the movement it will be necessary to have a rail rate not exceeding the total cost to the consignee of the present method of handling the ingot molds via barge-motor service.

Cost Considerations

Cost studies were submitted by the respondents and the protestants. They are discussed in detail in the appendix hereto. As stated therein, the respondents computed out-of-pocket costs as 483.5 cents, utilizing eastern district and southern region costs based on railroad cost scales by territories for the year 1961, contained in public statement No. 5-63 prepared by our cost finding section, and as 468.9 cents, by the application of Rail Form A to operating data of each respondent for the year 1962. Excluding return on investment, the respective costs are shown as 432 and 419 cents. Fully distributed costs are shown as 759.4 cents.

The protestants restated the respondents' statement No. 5-63 costs as 505.8 cents on an out-of-pocket basis, and 785 cents on a fully distributed basis. They also compute the average rail full cost by various methods as 759.4, 617.1, 687.9, and 564.3 cents. These methods are described in the appendix hereto, and the differences in the out-of-pocket and fully distributed costs as computed by the respondents and the protestants are also discussed therein.

Recognizing that costs are not always ascertainable with mathematical precision, we have found in the appendix hereto that the rail out-of-pocket costs reasonably approximate 468.9 cents, as shown by the respondents upon individual application. Eliminating return on in-

vestment,[6] they would be substantially lower. The rail fully distributed cost figure of approximately 759 cents is reached in a manner consistent with recognized procedures if the use of territorial averages is accepted. Having found the costs upon individual application to be more appropriate however, those on a fully distributed basis would be somewhat lower than 759 cents. We therefore find that the proposed rate exceeds the respondents' out-of-pocket costs, but is below their fully distributed costs.

The protestants, based on the Commission cost section's new Barge C formula, compute the cost of transporting this traffic by the Mississippi Valley Barge Line Company. The record fails to demonstrate, however, that those costs are reasonably representative of the costs of all protestants of record. In any event, when the aggregate charges of $1.79 for barge-to-truck transfer and for-hire trucking are included,[7] the full costs are computed as 535.68 cents, based on an operating ratio for that bargeline of 87.9 percent (the company's average for the last 3 years), and as $5.1959, including a return on investment of 4 percent. To compare validly with rail fully distributed costs, use of the latter figure is more appropriate.

Four transportation economists testified in respondents' behalf to the effect that incremental or out-of-pocket cost, rather than fully distributed cost, is the proper basis both for establishing pricing floors and also for determining the most economic form of transportation. They urge that no meaningful comparison of full costs can be made in this proceeding because of the dissimilarity between the rail and water cost formulas in allocating overhead

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[6] *Cf. Coal from Southern Mines to Tampa and Sutton, Fla.*, 318 I.C.C. 371; *Baltimore & O. R. Co.* v. *Chicago & E. I. R. Co.*, 322 I.C.C. 572.

[7] See *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 784, 785.

costs to the traffic involved. They further contend that only in competitive situations between regulated modes has the use of fully distributed costs ordinarily been found controlling, and that there is no sound justification for such usage.

Service Considerations

Protestants contend that the bargelines are disadvantaged at a parity of charges because of inferior service, and cite the loss of other traffic when differentials were eliminated. However, a comparison of the services indicates that loss and damage has not been experienced on the barge movement and the consignee anticipates none on the rail movement. The rail line-haul service is faster. Nevertheless, considering that plant facilities are adequate to receive shipments of 600 gross tons and the movement is primarily to stockpile, the advantages of faster rail service are not material to consignee. The consignor bears the cost, and must arrange, for the movement of the traffic from its mill to the barge dock and for loading the traffic into the barge. The rail service is door to door, but the intraplant switching of rail cars is performed by the consignee in its equipment and at its expense. It is protestants' position that they can only participate in this traffic when the cost to the shipper is less than all-rail service.

General Discussion and Ultimate Conclusions

For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the Nation's transportation system is to be healthy. Thus, whenever competive carriers of different modes assert cost advantages inherent to their respective modes, we have recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is

reasonably practicable to apportion. Difficulties of apportioning constant costs do prevail. See *Grain in Multiple-Car Shipments—River Crossings to So.*, 321 I.C.C. 582, 597, reversed on other grounds in *Cincinnati, N. O. & T. P. R. Co.* v. *United States*, 220 F. Supp. 46 (S. D. Ohio 1963), appeal docketed, U. S. July 29, 1964, (No. 545). Since constant costs are not directly related to service units, they are assigned on an average statistical basis. In our opinion, however, that assignment does not detract from their worth.[8] We adhere to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented. Stated differently, we recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced herein by respondents ignores them. We decline to so limit our ratemaking powers.

However, a determination that the advantage of low cost lies with one mode or another does not end matters. Nor is such a determination necessarily to be equated with the appropriate rate level. We are not bound by a mechanical formula. Rather, it must be found that a competing rate is destructive of such an advantage. A finding to this effect must of necessity rest with the facts and circumstances in each case.[9] Here, it cannot be controverted that protestant bargelines have chosen for some time to forego the revenues of a rate set at a level which would return fully distributed costs. They have done so voluntarily and, considering the rail rate levels and the fact that the traffic has moved almost exclusively by barge since 1953, without being subject to any compe-

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[8] Compare our action in divisions cases under section 15(6) in *Louisville & N. R. Co.* v. *Southern Ry. Co.*, 319 I.C.C. 639, 660, sustained in *Carolina & N.W. Ry. Co.* v. *United States*, 230 F. Supp. 581 (W. D. N. C. 1964), appeal docketed, U. S. Nov. 16, 1964.

[9] *Cf. Reduced Transcontinental Lumber Rates, 1961*, 318 I.C.C. 815, 844.

titive compulsion insofar as respondents are concerned.[10] From all that appears of record, protestants' choice in setting their rate at the level respondents now seek merely to meet was also reached voluntarily. Such action affords no basis for assuming that the action of respondents in meeting but not undercutting protestants' rate destroys an inherent cost advantage. Indeed, we think it plain that protestants, being in a position of their own free choosing, cannot successfully object to a rate which, we find, will return revenues reasonably in excess of out-of-pocket costs and which is designed merely to meet competition with its resulting benefit to the shipping public. It is well to note as to shippers that there is a public interest aspect in reductions to be achieved through competitive rate making which we are required to recognize in addition to the revenue considerations of the respective modes. Moreover, the proposed rate reasonably appears to be designed to contribute in the aggregate to the constant costs and will afford respondents the opportunity to utilize equipment more fully thereby reducing unit costs. This is so despite protestants' assertion that respondents received greater revenue in excess of out-of-pocket costs under the present $11.86 rate in 1963 in handling five carloads of the involved traffic than they would if they had secured, under the proposed rate, the entire 1963 tonnage which moved by barge and rail. A contrary and more accurate result obtains when the costs we have found appropriate herein (468.9 cents) are utilized. Moreover, the steady rise in traffic movements in 1961, 1962, and 1963 permits an inference that greater tonnage will be available for future movements. Finally,

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[10] The last-mentioned factor in particular, as well as those discussed hereinafter, clearly distinguishes the instant proceeding from the situations presented in *Grain from Idaho, Oreg. & Wash. to Ports in Oreg. & Wash.*, 319 I.C.C. 534 (since reopened for further hearing), and *Pig Iron, Buffalo, N. Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121.

we see no basis for limiting respondents to what are in actuality isolated movements on special orders which may or may not occur again, or to subject the receiver to the much higher charges in such instances. In view of the foregoing, we find the proposed rate compensatory, and just and reasonable. It may readily be inferred that protestants would have raised their rate to a higher level heretofore had they themselves deemed it appropriate to protect their inherent advantage. However, their realization of what we must assume in the circumstances to be a profitable level of revenue at lower rates negates any sound basis for finding destructive competition or a tendency thereto. Indeed, the record impels the conclusion that protestants' cost advantage is such that they are in a position to continue to compete effectively and still charge a rate reasonably in excess of out-of-pocket costs, *cf. Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 761, n. 14 (1963), hereinafter called the *New Haven* case, even if they were to reduce their rate. Stated in another manner, the situation presented is one permitting the reasonable play of competition. *Cf.* Testimony of then Chairman Freas in Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce on Problems of the Railroads, 85th Cong., 2d sess., pt. 3, at 1884 *passim* (1958).

Service considerations as to the involved movement are not shown of record to be controlling. For example, stockpiling and adequate storage space do not necessitate faster service as such. In addition, certain aspects of the two services may be said to be largely offsetting. In this regard, the consignor must arrange for the movement to, and loading on, the barge when such service is utilized. Initially, it is not urged nor is it shown that this service factor and the absorption of the attendant costs by the consignor influence the routing of the traffic. *Cf. Penn-*

sylvania R. Co. v. *United States*, 202 F. Supp. 584 (E. D. Pa. 1962). As an offsetting factor, the consignee is required to perform intraplant switching in its own equipment at its expense. In any event, even assuming inferiorities in protestants' service, there would be corresponding advantages in that of respondents. The national transportation policy is directed to a recognition and preservation of inherent advantages.

In the circumstances presented, we find for the encouragement of lawful competition and conclude that the proposed rate is just and reasonable, and, consistent with the Court's evaluation of section 15a(3) in the *New Haven case*, not destructively competitive.

COMMISSIONER TUCKER concurs in the result.

It is ordered, That this proceeding be, and it is hereby, discontinued.

By the Commission, division 2.

BERTHA F. ARMES,
Acting Secretary

(SEAL)

APPENDIX

RESPONDENTS' COST STUDIES

The respondents submitted four cost studies. Two studies were based upon eastern district and southern region out-of-pocket costs, as shown in I.C.C. Statement No. 5-63. The other two are hereinafter referred to. The respondents also computed fully distributed costs using the eastern district for the Pennsylvania portion of the haul and the southern region for the L. & N. portion of

the haul. These fully distributed costs amounted to 759.4 cents per gross ton.

Territorial studies.—In their cost studies based on Statement 5-63, respondents applied territorial unit costs based on 50 gross tons per car, 600 gross tons per shipment, or a 12-car block with territorial average empty returns in order to reflect what they suggest to be the greatest cost anticipated from this movement.

For the purposes of the above cost studies, the P. C. & Y. and the Pennsylvania costs are based on eastern district out-of-pocket unit costs; and the L. & N. costs are based on southern region out-of-pocket unit costs. The cost study for the southern region was on the same basis as that for the eastern district.

The following are the out-of-pocket costs developed in these studies by respondents in transporting the traffic by rail;

	Total out-of-pocket costs	
	Including return on investment	Excluding return on investment
	(In cents per gross ton)	
P.C. & Y.-Pennsylvania costs based on eastern district Rail Form A (1961)	338.3	304.0
L. & N. costs based on southern region Rail Form A (1961)	145.2	128.0
Total	483.5	432.0

The respondents used the short routes of movement from Neville Island, Pa., to Duffs Junction or Scully, Pa., over the P. C. & Y. plus the movement beyond, over the Pennsylvania, to the latter's interchange point with the L. & N. at Cincinnati, Ohio. This movement involved 311 miles, 7 miles over P. C. & Y., and the remainder over the Pennsylvania.

The multiple-car shipment would be picked up at the interchange point by through train PMC-3 moving from Pitcairn Yard on the Pennsylvania to Columbus, Ohio. At Columbus it would be switched into train CIN-1 for movement to Cincinnati. From this point to Steelton, Ky., movement would be over the L. & N. for a distance of 220 miles. The entire movement would total 531 miles.

The respondents stated that, since the P. C. & Y. was a class II railroad, there was not available any cost data relative to its operation. For the 7-mile movement by that carrier from Neville Island to Duffs Junction, respondents used the origin terminal, way train, and interchange cost for the eastern district. Also, because this was a proposed movement it was not possible to develop any savings on the P. C. & Y. relative to billing costs and switching time; therefore, eastern district averages were used.

The movement from the interchange point at Scully to Cincinnati was costed on the basis of using the eastern district costs for the movement over the Pennsylvania.

As to switching operations, the respondents did not make any time study to the origination of a car but instead used the average eastern district switching minutes. They allowed 15.29 minutes each to place the empty car and remove the loaded car. These 15.29 minutes were, in turn, multiplied by 12 cars which totaled to 183.5 minutes. To place empties and remove loaded cars, the respondents, therefore, allowed 367 minutes. This operation was estimated to be 6 hours.

At the interchange point there were 7.65 minutes average per car for 12 cars. The interchange costs were increased for empty return movement; and the empty return ratio on gondola cars for the eastern district was used (74 percent). The respondents added 67.9 minutes

to handle the empties, and the total at the interchange point was given as 159.7 minutes.

For intertrain and intratrain switching, which respondents used at Columbus, the average per car was 4.59 minutes; this, in turn, was multiplied by 12 which resulted in 55.1 minutes. The above minutes were increased by the empty return ratio of 74 percent resulting in 95.9 minutes for switching at Columbus. This operation involved the handling from train PMC-3 to train CIN-1. Since the considered traffic was not moving in multiple cars, the respondents relied upon averages and these averages, they claim, overstated the movement.

Individual applications.—The respondents' other two cost studies were based on individual applications of Rail Form A for the Pennsylvania and the L. & N. for the year 1962. The individual application of Rail Form A formula for the Pennsylvania was developed for two purposes, one to show that the costs developed under Rail Form A are comparable to the eastern district costs with respect to the Pennsylvania costs; and secondly, as the respondents did not have available eastern district costs for the year 1962, the individual Rail Form A study was presented in substitution. Thus, the movement from the interchange point at Scully to Cincinnati was costed by applying cost factors developed under Rail Form A prepared for the Pennsylvania. Eastern district average origin terminal, way train, and interchange cost was applied for the move over the P. C. & Y.

The L. & N. also applied the individual application of Rail Form A formula for the year 1962. The purpose of its application is the same as that mentioned above for the Pennsylvania. The former also made adjustments of the interchange switching at Cincinnati (Decoursey Yard) with the Pennsylvania.

There was some doubt expressed by protestants regarding the switching at Decoursey Yard as to whether trains No. 75 and No. 158, used for this transportation beyond Cincinnati, were way trains or through trains, because some switching might be involved. This respondent stated that these trains are different from a way train or so-called local train in that they do no switching en route, while a local freight does. However, a through train may at certain points have a setoff of cars for business purposes but there is no switching involved. The L. & N. maintains that it should not take more than 25 minutes to set off cars at the Steelton plant.

The interchange switching at Cincinnati with the Pennsylvania was adjusted to reflect the cost resulting from this move. The cost per carload as shown by the L. & N. is $4.63. Also, intermediate switching at Louisville, Ky., has been adjusted to 40 percent of the average intermediate switching cost. This results in an intermediate switching cost of $2.69 per carload.

With respect to costs developed under the individual applications of Rail Form A formula for the Pennsylvania and the L. & N., the following is shown:

	Total out-of-pocket costs	
	Including return on investment	Excluding return on investment
	(In cents per gross ton)	
P.C. & Y. cost based on eastern district Rail Form A (1961); and Pennsylvania cost based on Pennsylvania Rail Form A (1962)	331.4	300.0
L. & N. cost based on L. & N. Rail Form A (1962)	137.5	119.0
Total	468.9	419.0

PROTESTANTS' RAIL COST STUDY

The protestants developed out-of-pocket and fully distributed costs applicable to movement of ingot molds in gondola cars, 112,000 pounds per car, 600 gross tons per shipment, from Neville Island to Steelton. These costs were based on territorial average costs utilizing Rail Carload Cost Scales by Territories for the Year 1961, Statement No. 5-63, prepared by the cost finding section.

The terminal costs were computed from table 3 of the above-mentioned statement and are the average of eastern district and southern region terminal costs for a gondola with a load of 50 tons and, in effect, assigned an eastern district origin cost, at Neville Island, and a southern region termination cost at Steelton.

The protestants used the docket No. 28300 mileage from Neville Island to Cincinnati increased 13 percent for circuity to encompass all the routes to Cincinnati. Eastern district unit costs were applied to the mileage. Further, the rate applies over the L. & N. beyond Cincinnati, and, therefore, the protestants apply southern region unit line-haul costs to the L. & N. mileage from that point to Steelton as shown in supplement 23, I.C.C. A-16622. The costs reflected the movements in way trains and through trains.

The total territorial interchange out-of-pocket costs per loaded car-mile and the constant cost per hundredweight mile were included in the respective line-haul costs. All unit costs per carload were divided by 50 gross tons, the number of gross tons in 112,000 pounds, the minimum weight per car for the $5.11 rate in the tariff. All unit costs shown in per hudred weight were multiplied by 22.4 to obtain unit cost per gross ton of 2,240 pounds.

A cost per gross ton of 5.6448 cents was included for loss and damage claim payments based on that shown for class 579 in appendix A, I.C.C. Statement No. 5-63.

The results of protestants' cost study for the traffic at issue indicate an out-of-pocket cost of 505.8 cents per gross ton and a fully distributed cost of 785.0 cents per gross ton.

Protestants also used respondents' 1961 eastern district and southern region costs to show average total cost (total operating expenses, return and recovery of passenger and less-than-carload deficits) allocated by Rail Form A, schedule G expense groups. The average total costs for the movement of ingot molds from Neville Island to Steelton using the method and operating factors employed by the rail respondents showed—

Movement (1)	Average total cost per gross ton (2)
	Cents
Within eastern district	475.0
Within southern region	212.9
Total	687.9

Water Costs

The Mississippi Valley Barge Line, hereinafter called the bargeline, introduced a cost study vased on Barge Form C. It was necessary, as stated by this protestant, to depart from Barge Form C in order to make several adjustments in the terminal areas at Pittsburgh, and in the unloading point at Owensboro, Ky., so as not to overstate costs on the actual movements involved in handling the traffic. The above is particularly true in respect to port service cost, i.e., tug and fleeting costs at origin and destination, which showed an average cost of $9.44 per loaded barge which represented the cost generally of maintaining and operating a fleeting area at Pittsburgh.

The bargeline did not complete its study of the cost of providing tug service at Pittsburgh. Instead, an anlysis was made of actual movements for the past 2 years and the actual costs incurred at Pittsburgh were noted after which an average cost was taken and included in port costs, as finally applied. The same approach was followed at Owensboro, Ky., and to the total average port cost, the cost per barge of maintaining a fleet at Pittsburgh was added to the average tug and fleeting cost. This protestant argues that the deviation in the matter of port service cost was proper when consideration was given to the fact that the Pittsburgh port area extended from Monaca, Pa. 24 miles below Pittsburgh to more than 100 miles north of Pittsburgh on the Monongahela River and 79 miles north of Pittsburgh on the Allegheny River. It states that the movement under study required tug movements of only 7 miles and contends that an anlysis of the actual tug expenses incurred would more accurately describe those costs than an average cost based on such a large port area as Pittsburgh.

Since all movements actually involved were made in line-haul barges and the actual time was noted in each barge's log, costs were computed at the particular barge's average hourly cost. This protestant did not maintain any fleeting area at Owensboro. Therefore, no cost of maintaining such was added as was done at Pittsburgh.

It is stated by the bargeline that the other departure from Barge Form C was in the application of barge costs to the actual movement. Computations were made to show the cost per day applicable to uncovered jumbo barges. These costs were based on calendar days due to the fact that in 1962 the protestant kept no record of so-called idle days. Consequently, there was shown the actual days that barges were utilized from the time of arrival at origin empty to date of departure with respect to the particular movement. In addition, it was shown that the

average empty en route time was 7.86 days. An average empty return ratio of 31.64 percent was applied on those days to provide an allocation of empty days en route associated to the particular movement. The empty return ratio on the lower Ohio River was calculated from the total empty miles of 33,916 to the total loaded miles of 98,950 and for the upper Ohio River the total empty miles of 6,535 to the total loaded miles of 28,883.

The bargeline showed a range in elapsed barge time, before application of empty return, of 14 days for barge MV-709 to 24 days for barge MV-744 and an overall average of 22.01 days.

The bargeline, in exhibit No. 24 (Barge Form C, corrected summary schedule, page 3, lines 27 through 39) showed the various cost elements applied to the study movement. Column (3) shows a cost based on operating expenses of $2.7993 per net ton and when expanded to reflect operating ratio of 87.9 percent (the average for the bargeline for the past 3 years) it amounted to $3.1846 per net ton. The latter figure was adjusted to $3.5668 per gross ton. It is stated that if the operating costs were increased to include return on investment at a rate of 4 percent for comparative purposes (the same rate generally used by railroads), the cost per net ton including return would be $3.0413 per net ton, instead of $2.7993, or $3.4059 per gross ton.

The bargeline shows that when the ancillary costs for transfer and trucking services at destination amounting to $1.79 per gross ton are included in the costs, the above figures become $5.3568 per gross ton on an operating ratio basis and $5.1959 per gross ton applying a return on investment of 4 percent.

Discussion of the Cost Evidence

We consider first the costs for rail movement.

In their statement No. 5-63 costs, respondents separated from the territorial line-haul costs the interchange switching and intertrain and intratrain switching and included these switchings as they occurred at Duffs Junction and Cincinnati. This procedure is acceptable, as Rail Form A provides for handling switching costs based on either: (1) actual known experience, or (2) on a mileage basis, when actual experience is not known.

Respondents' station clerical costs were not reduced to one-twelfth to reflect the fact that the shipment would be handled in 12-car multiple shipments.

Respondents' use of eastern district average through train weights is based on a 4- or 5-day study sufficiently representative of the proposed operations to be considered reasonably reliable. Similarly, for that portion of the traffic originating on and moving over the P. C. & Y., the respondents' use of the eastern district costs for origin terminal, way train, and interchange produces acceptable costs for that carrier.

Respondents' routing to Steelton of 531 miles was determined by using the actual distance over the P. C. & Y. to Duffs Junction of 7 miles, thence the Pennsylvania to Cincinnati of 304 miles, and then the L. & N. to destination of 220 miles. This routing, involving one actual interchange with no circuity added to the actual miles, is reasonable.

Protestants' rail cost study included 5.6448 cents per gross ton for loss and damage claim payments. This was the average for 1961 of some 20 different items, including iron, steel, and other metallic articles. The respondents in their cost computations did not include any item of

cost for this since the nature of the commodity involved makes unlikely the occurrence of loss and damage. Nor has the consignee experienced any loss or damage. In the circumstances, we agree with this omission.

The protestants made an adjustment in their costs for movements in 600-ton lots, a tariff requirement for the $5.11 rate, by dividing the station clerical expense by 12, the number of 50-gross-ton loaded cars in a 600-gross-ton movement.

Comparison of the respondents' and protestants' rail costs based on statement No. 5-63. (These costs include return on investment and allowance for Federal income taxes.)

	Rate	Out-of-pocket cost	Constant cost	Fully distributed cost
Respondents' exhibits Nos. 9 and 12 (excluding loss and damage)	511	483.5	275.9	759.4
Protestants' exhibit No. 5 (including loss and damage)	511	505.8	279.2	785.0

The respondents' out-of-pocket rail cost study in the eastern district is 14.8 cents more than protestants' out-of-pocket rail cost for the same district. The protestants' out-of-pocket rail cost study in the southern region is 31.4 cents more than the respondents' out-of-pocket rail cost for the same region. Thus, protestants' out-of-pocket rail cost study is 16.6 cents more than respondents'. This latter cost difference does not consider loss and damage costs. Respondents, as stated above, did not include a loss and damage cost in their study, whereas protestants included a cost of 5.6 cents per gross ton. Thus, adding the 5.6 cents to the 16.6 cents provides 22 cents, which

is the total difference between respondents' and protestants' out-of-pocket cost studies.

Protestants in their restatement of respondents' Statement 5-63 costs claim that respondents reduced their out-of-pocket switching costs in the southern region by 32.5 cents per gross ton based solely upon an operation described by an operating witness for respondents. According to protestants, the rail out-of-pocket cost restated to correct for this allegedly unwarranted adjustment in switching costs would be 516 cents per gross ton or 5 cents more than the proposed rate. The 516 cents is obtained by adding the 32.5 cents to respondents' cost of 483.5 cents per gross ton. Indeed, protestants' costs did not reflect any estimate of the reduction in costs (other than station clerical) for handling multiple-car shipments in heavier than average weight trains. However, cost reductions in such instances may be said to be axiomatic. *Asphalt to Iowa, Michigan, Minnesota, and Wisconsin*, 316 I.C.C. 117, 124. See also *Volume rates on Processed Meal—Midwest to Ports*, 322 I.C.C. 456, 485. Rail Form A computations recognize only to a limited degree reductions resulting from multiple-car shipments because applicable Rail Form A costs are based on average switching cost per car resulting from switching cuts of cars of various sizes.

Recent and pertinent cost experience of the past often furnishes an appropriate guide in judging rates for the future. However, if a carrier's costs per 100 pounds or other unit have been high because of low volume of traffic, the use of such costs to determine the reasonableness of a proposed rate, the very purpose of which is to increase a carrier's business, should of necessity be given careful consideration. For example, had the tonnage which a new rate is expected to produce been included in cost calculations the resulting costs would be much lower. Stated in another manner, in judging rates for the future reason-

able prognostications should be given weight. Here, respondents' expert operating witness testified that, in his opinion and on the basis of past experience, a reduction of switching costs would result from the proposed multiple-car movements. As indicated, cost reductions in such situations are axiomatic. Moreover, protestants' cost witness appeared to recognize the foregoing for, when asked if anything, in his opinion, would preclude an actual reduction of the costs resulting from multiple-car movements, he stated:

> No, sir. A study that would be made which would show the time elements for the various types of switching could be made, and it would adjust from the particular point at which the formula had actually developed cost.

In light of the foregoing and since the respondents' witness has not been successfully rebutted, we conclude that the reduction in switching costs would occur. We are convinced that it is more reasonable to recognize the reduction than to reject it.

As to the respondents' individual Rail Form A applications, apart from the aforementioned criticisms as to the territorial costs, protestants appear to find fault here only to the extent that the Pennsylvania did not show the system factors used in preparing its individual carrier costs. However, it appears of record that the respondents' working papers were submitted to the protestants and stood unchallenged at the hearing. In our opinion, the individual cost applications reflect reasonable adjustments appropriate in the circumstances for proposed movements, and stand unrebutted. We so find. While costs cannot be pinpointed here exactly, we conclude that the out-of-pocket costs for the proposed movement reasonably approximate those adduced by respondents by individual application; individual, more specific showings being preferable to territorial averages.

Intermodal cost comparisons

Cost level (1)	Respondents (2)	Protestants (3)	(4)
	(In cents per gross ton)		
1. Rail out-of-pocket costs:			
1. Territorial costs, statement No. 5-63, adjusted	[1]483.5	[2]505.8	[3]516.0
2. Individual Rail Form A Pennsylvania and L. & N.	[1]468.9		
2. Rail fully distributed costs:			
1. Territorial costs, statement No. 5-63, adjusted	759.4	[2]785.05	(a)759.4
3. Rail average total cost: (or "Full Cost")			(b)617.1 (c)687.9 (d)564.3
4. Barge costs: Average total		[4]519.6 [5]535.6	

[1] Includes movement of P.C. & Y at eastern district costs for 1961.

[2] This figure was computed and submitted by protestants (Waterways Freight Bureau).

[3] Respondents' territorial out-of-pocket costs (483.5 cents per gross ton) corrected by protestants to adjust for respondents' understatement of switching costs in the southern region; i.e., 32.5 cents (483.5 + 32.5 = 516).

[4] Includes the ancillary charge for transfer and trucking services at destination of 179.0 cents per gross ton plus an operating cost of 340.6 cents per gross ton which included a 4-percent return on investment after Federal income taxes. The latter figure (340.6 cents) is derived by applying return on investment ratios to the respective towboat, barge, and port service costs to arrive at a total cost of $2,119.93 per bargeload. This figure, in turn, is divided by the "load-per-barge factor" of 701.75 net tons (2,000 pounds) resulting in a cost of 3.0209 cents per net ton, to which is added the cargo loss and damage cost of 2.01 cents per ton and provides a cost of 3.0410 cents per net ton. The latter figure is then multiplied by the ratio of 1.12 to expand from cents per net ton to cents per

The above figures for items (a), (b), (c), and (d) represent the result of the protestants' four basic methods for determining "rail full cost." All calculations are based on respondents' territorial costs, statement No. 5-63 adjusted, from which respondents developed an out-of-pocket cost of 483.5 cents per gross ton. The following identifies the four methods:

(a) *Distribution of rail constant costs on basis of service units.*—This method uses the Rail Form A ton and ton-mile distribution of constant costs, which protestant determines to be 275.9 cents and added to respondents' out-of-pocket cost of 483.5 cents to provide the cost of 759.4 cents per gross ton.

(b) *Distribution of rail constant cost on basis of revenue need.*—This method increases the out-of-pocket costs (483.5 cents) by a "carload revenue need ration," determined separately for the eastern district and southern region by dividing the total sum of (1) gross freight revenue—carload, and (2) freight switching revenue (total out-of-pocket expense—carload minus Switching and Terminal Co. out-of-pocket expense and return). The resulting ratios are: eastern district, 1.209; southern region, 1.433. The calculations are:

	Out-of-pocket	Revenue need ratio	Total
	Cents		*Cents*
Eastern district	338.3	1.209	409.0
Southern region	145.2	1.433	208.1
Total	483.5	.....	617.1

gross ton, which produces an operating cost of 340.6 cents per gross ton.

[5] Includes barge costs of 279.93 cents per net ton (or 313.52 cents per gross ton) divided by an operating ratio of 87.9 which provides the figure of 356.68 plus 179 cents per gross ton for ancillary charge resulting in 535.68.

(c) *Average total cost including return on investment and operating deficits.*—Average total cost here consists of total operating expenses, rents, and taxes; 4 percent return on investment (100 percent of road and equipment), after Federal income taxes; and passenger and less-than-carload deficits (exhibit No. 35).

(d) *Average total cost including average revenue need.*—This method consists of rail total operating expenses, rents, and taxes (excluding Federal income taxes) increased by an "average revenue need," the latter revenue need being computed as the ratio of freight operating revenue to freight operating expenses, rents, and taxes (excluding Federal income taxes).

APPENDIX D

Served December 2, 1965

30300

INTERSTATE COMMERCE COMMISSION

Investigation and Suspension Docket No. 8038

INGOT MOLDS, PA., TO STEELTON, KY.

Decided November 9, 1965

On reconsideration, reduced multiple-car railroad rate on ingot molds, mold stools, and sprue plates from Neville Island and Pittsburgh, Pa., to Steelton, Ky., found unjust and unreasonable, and in contravention of the national transportation policy. Findings in prior report, 323 I.C.C. 758, reversed, schedules ordered canceled, and proceeding discontinued.

Appearances as shown in the prior report and, in addition, *Thomas M. Knebel* and *Bryce Rea, Jr.*, for intervener.

REPORT AND ORDER OF THE COMMISSION ON RECONSIDERATION

BROWN, *Commissioner:*

In the prior report, 323 I.C.C. 758, decided February 2, 1965, division 2 found just, reasonable, and otherwise

lawful the reduced railroad rate [1] of $5.11 on ingot molds, mold stools, and sprue plates, hereinafter called ingot molds, from Neville Island and Pittsburgh, Pa., to Steelton, Ky. Upon petition of the respondent railroads [2] and the protestant bargelines,[3] the proceeding was reopened by the Commission for reconsideration on the present record. The National Motor Freight Traffic Association, Inc., was permitted to intervene and file a reply to the respondents' petition.

These schedules became effective March 19, 1965. For convenience, however, the rate at issue will be called the proposed rate. The facts are adequately set forth in the prior report, and will be restated only where helpful for a clear understanding of the issues.

Since 1953, the movement of this traffic has been principally by barge-truck. The overall charge of $5.11 for movement by barge-truck consists of a barge rate of $3.32, minimum 600 gross tons, a barge-to-truck transfer charge of 95 cents at Owensboro, Ky., and a for-hire truck charge of 84 cents beyond. In 1953, the barge rate was $2.84, minimum 500 gross tons. That rate was subsequently increased to the present level and minimum, which were attained in November 1960.

Prior to the publication of the proposed rate, rail shipments were limited to instances of special orders for ingot molds required by the receiver's production schedules. According to consignee testimony, railroads cannot effectively participate in the movement, unless their rate

[1] Rates, costs, charges, and differences therein are stated per gross ton, unless otherwise indicated.

[2] The Pennsylvania Railroad Company (the Pennsylvania) and the Louisville and Nashville Railroad Company (the L. & N.).

[3] Mississippi Valley Barge Line Company (Mississippi), The Ohio River Company (Ohio), and Union Barge Line Corporation (Union).

would not exceed the total cost to the consignee of barge-truck service. As noted above, that cost is $5.11. The present rail rate is $11.86,[4] subject to a carload minimum of 100,000 pounds. The proposal applies to a minimum of 600 gross tons in single shipments, minimum 112,000 pounds per car, on one bill of lading from one consignor at one origin to one consignee at one destination, tendered in one day.

In approving the rate, division 2, noted that—

> * * * protestant bargelines have chosen for some time to forego the revenues of a rate set at a level which would return fully distributed costs. They have done so voluntarily and, considering the rail rate levels and the fact that the traffic has moved almost exclusively by barge since 1953, without being subject to any competitive compulsion insofar as respondents are concerned. * * * From all that appears of record, protestants' choice in setting their rate at the level respondents now seek merely to meet was also reached voluntarily. Such action affords no basis for assuming that the action of respondents in meeting but not undercutting protestants' rate destroys an inherent cost advantage. Indeed, we think it plain that protestants, being in a position of their own free choosing, cannot successfully object to a rate which, we find, will return revenues reasonably in excess of out-of-pocket costs * * *. [323 I.C.C. 758, 763.]

Division 2 then concluded that the rate was compensatory and just and reasonable and not a destructive competitive practice in derogation of the national transportation policy.

The respondents, in their petition for reconsideration, request that division 2's report be modified. They urge

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[4] Conversion to a gross-ton basis of the rate of $10.59 published per net ton, effective in February 1963.

the elimination of a policy statement to the effect that fully distributed costs are adhered to by the Commission in determining the low-cost mode. It is respondents' position that only out-of-pocket (incremental) costs of the proponent carrier should be considered, and that a rate which exceeds such costs is lawful. In their view no reliable intermodal cost comparison can be made and none should be attempted. The protestants, however, argue that intermodal cost comparisons should be made and that those compared should be on the full-cost level.

In their petition, the protestant bargelines argue that the report of division 2 is contrary to the legislative history of section 15a(3) of the Interstate Commerce Act, and cannot be reconciled with any reasonable theory of destructive competition, as reflected in the national transportation policy.

No serious dispute is raised on petition as to the analysis of the cost evidence in the prior report. We adopt such statements therein as our own. The proposed rate exceeds the rail respondents' out-of-pocket cost of 468.9 cents by 42.1 cents. The rail fully distributed cost is 759.4 cents, and the comparable full cost for barge-truck service is 519.6 [5] cents. The proposed rate, which is on parity with the total charges for barge-truck service, is below the rail fully distributed cost by 248.4 cents and below the barge-truck full cost by 8.6 cents.

The protestants contend that the costs of Mississippi are typical of the costs of all barge protestants herein since the cost factors for the different carrier lines are very similar. Mississippi handled 10 of the 19 shipments in the period 1961-63, and we accept the cost figures from its data as representative for our purposes herein.

[5] Includes barge full costs of 340.6 cents, plus the barge-to-truck transfer charge of 95 cents and the for-hire truck charge of 84 cents.

The costs of providing additional services attending the movement of traffic by barge are not shown on this record. Division 2, relying on the Commission's findings in *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 784, added the aggregate of such charges to the barge costs in computing the full cost of barge-truck service herein. Under the circumstances here present, we accept the division's computation of barge-truck costs.

Division 2 further concluded that other service considerations of the competing modes were not shown of record to be controlling. We agree that in this context neither mode possesses any material inherent service advantage.

Discussion and Conclusions

Simply stated, the railroads are here proposing a rate of $5.11, that meets the charges, $5.11, to the shipper who utilizes barge-truck. The rail rate is below its fully distributed costs of $7.59. The barge-truck charges are below its fully distributed costs of 519.6 cents but, as noted, the barge-truck fully distributed costs are considerably lower than those of the railroads. Under equal charges, rail respondents virtually concede that all of the traffic would move by rail.

Section 15a(3) of the act provides that—

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of

the national transportation policy declared in this Act.

As pertinent here, the national transportation policy provides for—

> * * * fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each * * * to promote * * * and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without * * * unfair or destructive competitive practices; * * *.

In *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 762 (1963), the Supreme Court observed that—

> The primary reason for the reference to the National Transportation Policy in § 15a(3) was to confirm the Commission's power to protect the inherent advantages of all carriers from destructive competition.

Cost is such an advantage. *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra*, 759.

The importance of this case rests upon the resolve of a fundamental proposition: the criteria for determining how the low-cost carrier's inherent advantages should be measured and protected. Such a determination comprehends a comparison of the cost advantages of two competing modes of carriage. It could not be determined, *in vacuo*, by viewing the operations of a single carrier or mode, as urged by the respondents.

In *Grain in Multiple-Car Shipments—River Crossings to So.*, 325 I.C.C. 752, 772, the Commission recognized that—

> Although the fully distributed cost standard requires an arbitrary assignment of constant costs to

particular traffic, that standard has generally been employed in measuring inherent cost advantages in intermodal competitive rate controversies.

In the prior report, division 2, concluded that—

> * * * whenever [regulated] competitive carriers of different modes assert cost advantages inherent to their respective modes, * * * [the Commission has] recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is reasonably practicable to apportion. [323 I.C.C. 758, 762.]

We agree. The rail respondents, however, argue against the use of such standard. On reply to protestants' petition for reconsideration respondents urge that—

> * * * a rate is "profitable" if it produces revenues in excess of the incremental [out-of-pocket] costs of providing the service. And a rate achieves maximum profits when the revenues per unit above the incremental cost of producing the unit, multiplied by the units sold reaches the optimum. This in turn depends upon the demand for the service at varying price levels. The optimum price being a function of the varying demand at different price levels, it follows that it may be relatively close to the incremental cost level or considerably above it. But if the price is optimum, regardless of its relationship to a fully distributed cost level determined by a statistical allocation of the constant expenses, it will make the maximum contribution to the pricer's net. * * * the optimum price oriented to the incremental cost as the floor is "fully compensatory" for no other price can produce as great a contribution. Thus, a fully compensatory rate is one which produces the maximum contribution; and for it to be achieved, the only relevant cost level is incremental cost. Within a multiservice industry, it will only be a coincidence, something equivalent to receiving 13 cards of one suit in a bridge hand, where the fully

compensatory rate—if this means the rate producing the maximum profit—happens to equal a statistically determined "fully distributed" costs.

* * * So far as the volume movement of ingot molds is concerned, the single car rate of $11.86 per ton, which existed prior to the reduced rate and still is available, has produced no traffic. While it exceeds the fully distributed cost level, it produces no net with respect to the volume movement of this traffic. Viewed from the railroads' standpoint, it is a "non-compensatory" rate since it generates no profits. By contrast, the reduced multiple car rate of $5.11 per ton will generate a considerable movement of the volume tonnage. If the shipper is to be believed, and the railroads believe him—and the Commission has no reason for doing otherwise—the rail rate must be at this level or lower if the railroads are to haul any of the volume movement. This reduced rate, which amply covers the incremental costs but falls short of the artificial fully distributed level, is therefore not only a profitable rate, but actually the most profitable rate the railroads can charge on this traffic. It is also, therefore, a "fully-compensatory" rate since no other rate would produce as much net.

We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, does not necessarily mean that the

carrier is the more efficient of the two. Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve.

Moreover, regulation could neither be fair nor impartial if we did not recognize the fact that the carriers before us do not compete for every type of traffic. It is quite obvious, for example, that the traffic here involved is of far more consequence to the barges than to the railroads. Analysis of 1962 systemwide revenues for the Waterways Freight Bureau's members indicates that iron and steel products, which includes ingot molds, is the third most important commodity group transported in barge service, accounting for 10.81 percent of their total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of the total barge revenue. In fact, the railroads readily concede this point. In short, an inherent cost advantage under the national transportation policy reasonably could not embrace a concept that would impair the ability of a carrier not only to compete but to exist.

In the prior report division 2 concluded that—

> It may readily be inferred that protestants would have raised their rate to a higher level * * * had they themselves deemed it appropriate to protect their inherent advantage. * * * protestants' cost advantage is such that they are in a position to continue to compete effectively and still charge a [reasonable] rate * * *. [323 I.C.C. 758, 764.]

We disagree. To have any validity the concept of an inherent cost advantage must have a definitive meaning. It could not, therefore, be framed within such a relative context, as suggested in the prior report. Either one mode or the other possesses an inherent cost advantage, and

that advantage is not subject to the sport of chance. That is to say, such an advantage cannot be lost merely by the creation, accidental or otherwise, of a rate below a fully distributed cost level. It appears so obvious here, for example, that the barge protestants were not aware of the precise cost level when their present rate was set.

In *Pig Iron, Buffalo, N. Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121, 129-130, the Commission, division 2, concluded that—

> * * * the principal purpose of the reference in section 15a(3) to the national transportation policy was to prevent a carrier from setting a rate which would impair or destroy the inherent advantages of a competing carrier, for example, by setting a rate, below its own fully distributed costs, which would force a competitor with a cost advantage on particular transportation to establish an unprofitable rate in order to attract traffic. It is readily apparent that if the reduced rates are approved from the five origins where protestant * * * [barge lines are] the low-cost carrier, any reductions in the water carrier rates necessitated thereby would necessarily be brought to a level below fully distributed cost. Therefore, the reduced rail rates result in a destructive competitive practice in contravention of the national transportation policy since the rates are substantially below the respondents' fully distributed costs and will force the protestant, which has a cost advantage, to establish unprofitable rates in order to remain competitive. This, in turn, would impair or destroy the protestant's inherent cost advantage.

As pointed out in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, *supra*, 757,

> There can be no doubt that the purpose of this provision [§ 15a(3)] was to permit the railroads to respond to competition by asserting whatever inherent advantages of cost and service they possessed.

In circumstances such as here presented where both the proponent carrier and the competing carrier are regulated, the Commission consistently has utilized the fully distributed cost standard to determine which mode of carriage possesses an inherent cost advantage. *Electric Cable & Wire, Worcester, Mass., to Houston, Tex.*, 319 I.C.C. 390; *Plastics from Texas to the East*, 319 I.C.C. 379; *Frozen Juice and Fruit from Florida to the North*, 319 I.C.C. 577; and *Candy and Confectionery from N. J., N. Y., & Pa. to Tex.*, 321 I.C.C. 154. Under that standard the rail respondents here do not possess an inherent cost advantage.

The propriety of using the fully distributed cost standard and questions respecting the proper construction of costs for the various modes are among the issues in the broad rulemaking proceeding of docket No. 34013, Rules Governing the Assembling and Presenting of Cost Evidence. A radical departure from the fully distributed cost norm as urged by the respondents would not be justified on the limited record here before us, particularly when such issues are to be determined on a comprehensive record in docket No. 34013.

The Supreme Court emphasized in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, *supra*, that—

> The principal reason for this reference [in § 15a(3) to the national transportation policy], as the hearings show, was to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes. And the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed

cost and thus perhaps to go out of business. [372 U.S., 744, 758.]

On a fully distributed basis, the low-cost mode of transport is barge-truck. We do not agree with division 2's conclusion that the barge "cost advantage is such that * * * [those carriers] are in a position to continue to compete effectively and still charge a rate reasonably in excess of out-of-pocket costs, * * * even if they were to reduce their rates." 323 I.C.C. 758, 764.

Nothing in that report suggests that such a reduction in the rate of the barge-motor lines cannot be matched by successive reductions in the railroad rates. The railroad out-of-pocket costs are lower than the barge-motor lines' variable costs. Therefore, the railroads can wage the rate battle as long as or longer than the barge-motor lines. The rationale of the division's report would permit no ground upon which the Commission would be able to intercede to halt such a devastating rate war. While this may give full rein to the "play of competition," 323 I.C.C. 758, 764, it is difficult, if not impossible, to comprehend how it would accord recognition and preservation of inherent advantages as contemplated by the national transportation policy.

In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. Cf. *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567, 575-579 (1947); *Dixie Carriers, Inc.* v. *United States*, 351 U.S. 56 (1956).

Upon reconsideration, we find the reduced multiple-car rate, minimum 600 gross tons per shipment, on ingot

molds from Neville Island and Pittsburgh, Pa., to Steelton, Ky., unjust and unreasonable, and in contravention of the national transportation policy. The findings in the prior report are reversed.

VICE CHAIRMAN BUSH, dissenting:

Carrier initiated ratemaking innovations, compatible with the requirements of law and practical factors such as numerous and varied present day operational and technological advancements by those subject to rate regulation by us, do not warrant disapproval by administrative fiat. The finding of unlawfulness herein rests, in my view of the record, solely upon an adverse concept, which is contrary to the provisions of the Interstate Commerce Act, as well as Commission and judicial precedent of long standing.

Conspicuous by its *absence* is an important element of proof of the lawfulness of the proposal, particularly in an intermodal rate adjustment, namely: the unrebutted evidence of a competitive necessity, which has been affirmatively shown of record by respondents. Under the facts here presented, I can find no justification for ignoring this essential ratemaking factor of longstanding precedent in making such a determination herein.

Conspicuous by its *presence*, however, is a purely speculative and unprecedented theory wholly without evidentiary support nor cogent supporting reasons, relative to the manner in which cost concepts are applied, allegedly to justify disapproval of the proposal. The determination of the compensatory nature of any rate proposal and of the necessity that it comport with the rule of ratemaking set forth in section 15a of the act, as amended, requires a comparison of like with like factors, rather than the comparison of data incompatible with each other. Admittedly, the involved rail and barge-truck rates are be-

low the fully distributed cost level for the respective modes as is determined herein. Appropriate consideration is then given to a comparison of the proposed rail rate with those costs incurred by the *rail proponents* in accord with our longstanding practice as recognized by all modes of regulated transport. Then, in circumvention of reality and by adoption of a concept of first impression, the determination rests upon the foregoing cost comparison with the barge-truck costs to the *shipper*, rather than costs of the barge-truck movement to such carriers, to prove they possess the inherent advantage of being the low-cost mode of transport. A realistic evaluation indicative of the falsity of such a costing concept for carrier transportation is self evident, for what it costs the shipper to move its traffic are the *rates* of the carrier plus any other additional shipper incurred expense; yet costs to the carrier, in the absence of unusual circumstances not here present, do not constitute the rate paid by the shipper. Were it otherwise, the inherent carrier cost advantage would not be susceptible of reasonable precision but would be a relative concept, determinable solely by presentation of expenses of unregulated noncarriers. Such is not contemplated by any provision of the act nor judicial requirement.

Finally, although it is incumbent upon us to recognize and preserve the inherent advantages, of which cost is only one, possessed by any rate-regulated mode as contemplated by the national transportation policy, it is not within our province to remain oblivious to the bargeline protestants' evidence of their inherent disadvantages due to *inferior service*. Such an admission against interest militates against the finding herein that neither mode possesses any material inherent service advantage, and adequately supports the conclusion that such is inherent in rail service.

Upon consideration of the record in its entirety, I would therefore find the proposal just, reasonable, and otherwise lawful and discontinue the proceeding.

COMMISSIONER FREAS, dissenting:

In *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra,* called *New Haven,* the Supreme Court indicated that "hard competition" was contemplated by section 15a(3), and that we were no longer to be "a giant handicapper." Yet, the majority now holds that a carrier with an inherent cost advantage must, nevertheless, be protected against another carrier which has not been a competitive factor heretofore and which seeks only to meet the going rate on a compensatory basis. If the instant holding reflects any reasoned consideration of "hard competition," it will surely come as a surprise to the successful proponents of both section 15a(3) and *New Haven.*

Moreover, the protection [6] would utilize fully distributed costs to set the rate level. It is one thing to utilize the fully distributed formula to determine the existence of an "inherent advantage" as between unlikes; it is quite another to use it as a pricing floor. In light of the arbitrary aspects [7] of fully distributed costs, I find it hard to square the majority's cavalier acceptance of those costs as a pricing floor with more relaxed and, to an extent, incremental, standards of other formulas. See, e.g., *Animal Feed from Kansas City, Mo., to Chicago,* 325 I.C.C. 147, *Carbon Blacks from the Southwest to Ind., Ohio & Mo.,* 325 I.C.C. 138, and *Aluminum Extrusions from Miami to Chicago,* 325 I.C.C. 188, and the approval given

[6] "Insulation" would be a more apt term.

[7] Including the failure to give effect to public costs. See *Grain in Multiple-Car Shipments—River Crossings to So.,* 318 I.C.C. 641, 682-683, 321 I.C.C. 582, 618-621 (dissenting opinion).

therein to significant departures from past costing practices, the pendency of docket No. 34013 notwithstanding. In essence, the majority's approach is nothing more than a return to the arbitrary percentage differentials struck down in *New Haven*. It is worthy to note, however, that as to a comparable proposal on a substantially similar movement the proponents thereof ultimately prevailed in court. *Pig Iron from Neville Island, Pa., to Louisville, Ky.*, 313 I.C.C. 771 (1961), reversed in *Pennsylvania R. Co.* v. *United States*, 202 F. Supp. 584 (E.D. Pa. 1962).

As I see it, the majority has come full circle to the pre-section 15a(3) days before 1958, and is once again indulging in the arbitrary allocating of traffic among the various modes. It has done so by equating, in effect, fully distributed costs with a profitable rate. However, the protestants, for whatever reason and certainly not because of rail competition, do not realize such costs. In the circumstances, it must be presumed that ingot mold traffic has returned satisfactory profits. Therefore, it is appropriate to ask what, in actual effect, is being protected since as a fact of competitive economic life protestants' advantage has been a mere cipher. Nor can I indulge in the majority's venture into speculation as to the danger to protestants' survival due to the possible loss of this specific traffic. In actuality, it forms a very small segment of protestants' tonnage and revenue. The majority's logic dictates, if the water carriers' interests are to be protected, a raising of their rate and indeed those of all carriers generally to the fully distributed level. Yet, such an approach has never been taken, nor is it readily apparent why this particular area of rate-making should necessarily be singled out for the restrictive embrace of price fixing at a high level. The majority by its own admission refuses to impose it elsewhere, presumably even where unregulated water carriage is involved.

It is indeed unfortunate that the majority has chosen to limit its ratemaking considerations to the inflexible framing of the issues by the parties.[8] One can understand the narrow position taken by the parties for, if fully distributed costs are to set the rate level, the water carriers need rarely fear rail competition. Conversely, if incremental or out-of-pocket costs both measure inherent advantage and set the rate level, relatively few rail reductions would merit disapproval. But ratemaking is not, and cannot be, limited by application of an inflexible mechanical formula. Once it is determined which mode has the low-cost advantage, the effect of a proposed rate must be measured in that light. To limit a proposed reduction in rate to the fully distributed level of another mode, regardless of the level of the other mode's rate or of other transportation circumstances, is patently anticompetitive. It must be determined whether there is room for reasonable competition. The writer so testified on behalf of the Commission in hearings which ultimately culminated in the passage of section 15a(3). See e.g., Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce on Problems of the Railroad, 85th Cong., 2d sess., pt. 3, at 1884 *passim* (1958). As I understand matters, the Congress nevertheless determined to avoid what is considered to be past inconsistencies by writing a specific provision eliminating some of the supposed previously existing paternalism imposed under section 15a (2). Such action was taken despite the existing requirement in section 15a(2) that consideration be given to the need, in the public interest, of adequate and efficient rail

[8] Such an approach does not, in my opinion, reflect the full consideration of the choice which must be made between different remedies with different consequences to the carriers and the public. *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 167-168. See also *Gilbertville Trucking Co.* v. *United States*, 371 U.S. 115, 130-131; *New Haven*, 372 U.S. 744, 763; *Atchison, T. & S. F. Ry. Co.* v. *United States*, 225 F. Supp. 584, 606-607 (D. Colo. 1964).

service at the lowest cost consistent with the furnishing of such service.

Section 15a(3) directs us to consider the facts and circumstances attending the movement of the traffic. If there is room for reasonable competition, then a rate may be approved since the inherent advantage of the low cost of the competing mode will still be preserved. That is, the low-cost mode will still be able to compete. *Accord; New Haven*, 372 U.S. 744, 761, n. 14. Here, the proposed rate meets, not undercuts, the water-truck rate and reasonably exceeds out-of-pocket costs in the circumstances presented. Yet, the water-truck rate can still be competitively reduced if such action proves necessary, despite shipper testimony to the contrary, to participate in the traffic.[9] Indeed, such a reduction, even a small one, would in all likelihood, recapture the traffic since any subsequent rail reduction would probably be noncompensatory. Such a conclusion is evident from a comparison on a hundredweight basis of the rail costs accepted as valid with the rail rate. The water-truck movement, on the other hand, would have lower variable costs if the 90-percent variable figure recently referred to in *Grain in Mutiple-Car Shipments—River Crossings to So.*, 325 I.C.C. 752, 774, n. 11 (1965), for example, is controlling. The statement in the report that the railroad out-of-pocket costs are lower than the barge-motor variable costs is presumably the result of accepting uncritically a variability figure approximating 100 percent for protestants; a figure not conceded by protestants and rightly so since it assumes that equipment is being put to full use all of the time, a millennium few carriers have reached. Apart from the foregoing weakness in the majority's approach,

[9] It should be observed that the conclusion that a reduction by protestants would be necessary to participate plainly implies a service advantage on the part of respondents at equal rates; an advantage which should not go unrecognized.

even a 90-percent figure should no doubt be lower if it is assumed, as it can be, that the truck costs erroneously equated [10] by the majority with the truck charge are, in fact, less than the latter.

Preserving an inherent advantage does not, in my opinion, mean rate stratification. *New Haven*, when read in its proper context,[11] and the legislative history stand for no such principle. The division report reached the correct result on both realistic economic and legal grounds, and, in so doing, properly accommodated the different views of the parties. I would affirm the findings in the report.

I can appreciate a quest for certainty in decision-making but there are no absolutes in the pragmatic, competitive world of ratemaking. By refusing to recognize legitimate commercial objectives, I believe the majority's action invites both reversal in court and legislative action. I am unwilling to assume that the underlying congressional efforts were for nought.

COMMISSIONER TIERNEY, dissenting:

I would affirm the findings in the prior report that the proposed rate is just and reasonable, and not destructively competitive.

The rate maintained by protestant bargelines and at which they transported the traffic over a period of years was not set at that particular level for any competitive reason. Under the circumstances we must assume that such rate was at a profitable level. Therefore, the fully distributed cost level cannot, in this situation, be said to

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[10] See *Eastern Central Motor Carriers Assn.* v. *United States*, 239 F. Supp. 591 (D.D.C. 1965).

[11] Similarly, a proper reading of the *Pig Iron* case, 321 I.C.C. 121, cited by the majority, will disclose that the proponents there sought to undercut substantially, not merely to meet, the low-cost mode. I submit that the distinction is material.

represent the lowest profitable level since the water carriers were apparently conducting profitable operations (in the absence of competitive rates) at a rate below their full cost of service. Cf. *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 759-761 (1963).

In a proceeding of this nature, the proponent of the rate must show (1) its costs, (2) that the proposal is just and reasonable from the standpoint of its own revenue requirements, and (3) that the proposal is not destructively competitive; and the party asserting that it has the inherent cost advantage must rebut the foregoing by showing *(a)* its costs, *(b)* the lowest level at which it may conduct competitive operations and continue to operate at a profit, and *(c)* the asserted differential, if one is necessary, for participation in the involved traffic. Here, the rails, in my opinion, have met their *prima facie* burden with evidence that the rate is just and reasonable and not destructively competitive; and the water carriers have not sufficiently rebutted such evidence. Accordingly, I would allow the public to receive the benefit of hard competition in the situation before us.

While the water carriers are the low-cost mode, there is no way to determine on the evidence of this record the lowest level at which they can effectively compete and continue to operate at a profit. Although the shipper testified of his intent to divide the traffic between the two modes, the respondents and protestants are in virtual agreement that at equal charges the shipper will tender all of the traffic to the rails. Under these circumstances, protestants were remiss in not furnishing us with the above-specified evidence.

The majority's action herein, utilizing arbitrarily the fully distributed cost level of the low-cost mode as a floor below which the high-cost mode cannot go in establishing

a competitive rate on a compensatory basis, in my opinion, is contrary to the legislative history of section 15a (3).

It is ordered, That the respondents herein be, and they are hereby, notified and required to cancel the schedules described in the order entered by the Commission's Board of Suspension on November 27, 1963, on or before January 3, 1966, upon not less than one day's notice to this Commission and to the general public by filing and posting in the manner prescribed under section 6 of the Interstate Commerce Act, and that this proceeding be, and it is hereby, discontinued.

By the Commission.

H. NEIL GARSON
Secretary

(SEAL)

APPENDIX E

I. NATIONAL TRANSPORTATION POLICY

(September 18, 1940.) (49 U.S.C., preceding §§ 1, 301, 901, and 1001.) It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of the Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

II. RULE OF RATE MAKING

Sec. 15a. (February 28, 1920; amended, June 16, 1933, September 18, 1940, August 12, 1958.) (49 U.S.C. § 15a).

(3) In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is

applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

SUPREME COURT, U. S.

No. 804

FILED
NOV 9 1967
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,
Appellants,

v.

LOUISVILLE & NASHVILLE RAILROAD CO. AND
PENNSYLVANIA RAILROAD CO., ET AL.,
Appellees.

On Appeal from the United States District Court for the Western District of Kentucky

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JURISDICTIONAL STATEMENT

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On Appeal from the United States District Court for the Western District of Kentucky

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JURISDICTIONAL STATEMENT

Appellants, American Trucking Associations, Inc., National Motor Freight Traffic Association, Inc., and National Tank Truck Carriers, Inc., appeal from a judgment of the United States District Court for the Western District of Kentucky which set aside an order of the Interstate Commerce Commission and remanded the case for further consideration. Appellants submit this statement to show that this Court has jurisdiction of the appeal and that substantial questions are presented.

OPINION BELOW

The opinion of the District Court in *Louisville & N. R.R. et al.* v. *United States, et al.* is reported at 268 F. Supp. 71.[1] The reports of the Interstate Commerce Commission's Division 2, and of the entire Commission on reconsideration appear at 323 I.C.C. 758 and 326 I.C.C. 77, respectively.[2]

JURISDICTION

This action was brought by appellees pursuant to the provisions of 28 U.S.C. §§ 1336, 2284 and 2321-2325 to enjoin, annul and set aside an order of the Interstate Commerce Commission in Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa., to Steelton, Ky.*, 326 I.C.C. 77 (1965). The judgment of the district court setting aside the order of the Interstate Commerce Commission and remanding the case for reconsideration was entered on May 15, 1967. Notice of appeal was filed by appellants in the district court on July 14, 1967. By order entered September 6, 1967, the district court extended the due date for docketing this appeal to and including October 13, 1967. The time for docketing was subsequently extended by Mr. Justice Stewart until November 9, 1967. This Court has jurisdiction under 28 U.S.C. §§ 1253 and 2101(b) to review the judgment of the district court on direct appeal. *I.C.C.* v. *New York, N.H. & H.R. Co.*, 372 U.S. 744; *Mechling Barge Lines* v. *United States*, 376 U.S. 375.

STATUTES INVOLVED

The National Transportation Policy, 49 U.S.C. preceding §§ 1, 301, 901, and 1001, Section 15a(3) of the In-

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[1] The opinion is reproduced as Appendix A to the Jurisdictional Statement filed November 7, 1967, by the barge lines (intervening defendants below) in *American Commercial Lines, Inc., et al.* v. *Louisville & N. R.R. et al.*, No. 797, October Term, 1967. The judgment of the district court is reproduced as Appendix B thereto.

[2] These reports are reproduced as Appendices C and D, respectively, of the barge lines' Jurisdictional Statement.

terstate Commerce Act, 49 U.S.C. § 15a(3), and Sections 8(c) and 10(e) of the Administrative Procedure Act, 5 U.S.C. §§ 557(c) and 706, respectively, are set forth in the appendix hereto.

QUESTIONS PRESENTED

1. Does section 15a(3) of the Interstate Commerce Act limit the Commission's power to determine the lawfulness of a competitively reduced rate to the single test of whether such rate is above the out-of-pocket (incremental) cost of the proponent thereof?

2. Does section 15a(3) preclude the Commission from using the full cost of the low-cost mode as the floor for a lawful competitive rate of the high-cost mode in order to recognize and preserve the inherent advantage of the low-cost mode?

3. Is the Commission's decision, as found by the district court, contrary to this Court's decision in *ICC* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744?

4. Did the Commission state a rational basis and adequate findings to support

   (a) its use of a comparison of full costs in determining which of the two competing modes has the inherent cost advantage, and

   (b) its use of the full costs of the low-cost mode as the floor for a lawful competitive rate of the high-cost mode?

STATEMENT

The involved order of the Interstate Commerce Commission directed the cancellation of a drastically reduced railroad rate ($5.11 in lieu of $11.86 per gross ton) on ingot molds and stools from a manufacturing plant at Neville Island, Pittsburgh, Pa., to a steel mill at Steelton,

Ky. That reduction was proposed to become effective December 1, 1963, for the purpose of diverting to rail service a substantial volume of traffic which had been transported over a barge-truck route [3] at charges of $5.11 per gross ton. The railroads virtually conceded that at equal charges the entire traffic would be diverted from barge-truck to rail.

Upon protest, the Commission suspended the proposed rail rate of $5.11 for investigation. It was shown at the hearing which followed that the fully distributed cost per gross ton of the two competitive services was $7.59 via rail and $5.19 via barge-truck; and that the out-of-pocket cost via rail was $4.689. The protesting barge carriers relied upon full cost in claiming an inherent advantage of lower cost of service which should be recognized and preserved. The railroads claimed that only their out-of-pocket (incremental) cost should be considered; that any rate which exceeds such cost is lawful; and that "no intermodal cost comparison should be attempted." The railroads relied upon the opinion testimony of four economists in support of their claims.

The Commission, Division 2, in a report of February 17, 1965 (323 I.C.C. 758), held, upon a comparison of the fully distributed costs of the competing modes, which comparison it found relevant to the issues, that the barge-truck service possessed the inherent advantage of lower cost. Division 2 held, nevertheless, that the proposed rail rate should be allowed to become effective because the barge-truck rate was 8 cents per gross ton below full cost and the barge-truck carriers thereby waived the right to have their inherent cost advantage preserved. Accordingly, the proposed reduced rail rate was permitted to become effective on March 19, 1965.

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[3] The barge-truck route embraced common carrier barge service on the Ohio River from Neville Island to Owensboro, Ky., and a 3.5-mile motor carrier haul from Owensboro to Steelton.

Two petitions for reconsideration were filed, one by the railroads to secure "the elimination of [the] policy statement to the effect that fully distributed costs are adhered to by the Commission in determining the low-cost mode," and one by the barge lines to secure the reversal of Division 2's holding on the point of waiver of their inherent cost advantage. The entire Commission, in its report on reconsideration of November 9, 1965 (326 I.C.C. 77), sustained the finding of Division 2 that full costs should be used to determine which mode possessed the inherent cost advantage. At the same time, it reversed Division 2 on the point of waiver on the ground that the right to assert and have an inherent cost advantage protected cannot be lost by mistake or inadvertence.[4] Accordingly, the Commission required cancellation of the $5.11 railroad rate on the ground that "by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage."[5]

The railroads against which the Commission's order of November 9, 1965, ran, filed suit in the district court to set it aside on the grounds that it was based on an erroneous interpretation and application of the governing statutory provisions and lacked a stated rational basis. Forty-eight additional large railroads intervened as plaintiffs to support that position. The Department of Justice chose to confess error and participated before the district court as an active plaintiff. These appellants, which represent the regulated motor-carrier segment of the national transportation system, intervened in support of the

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[4] The Commission noted, 326 I.C.C. 83, that it was "obvious . . . that the barge protestants were not aware of the precise cost level when their present rate was set."

[5] As noted, *supra*, p. 4, this rail rate was substantially ($2.48) below their full cost.

Commission's order.[6] The district court held that the assailed order should be set aside on the grounds urged by the plaintiffs and the cause remanded to the Commission for further proceedings consistent with its opinion.

THE QUESTIONS ARE SUBSTANTIAL.

This appeal brings to this Court questions as to the Commission's power under section 15a(3) of the Interstate Commerce Act which were left open in *ICC* v. *New York, N. H. & H. R.R.*, 372 U.S. 744, 760 (1963) (hereinafter referred to as *New Haven*), namely, "how . . . [a] carrier's inherent advantages should be measured or protected."

The Commission's resolution of those questions was held invalid by the district court for two reasons: (1) for lack of a stated rational basis and (2), on the ground that the Commission misconstrued and misapplied the governing statutes—§ 15a(3) of the Interstate Commerce Act and the National Transportation Policy. According to the district court, those statutes should have been read as permitting carriers, in typical cases involving competition between different modes of transportation such as the instant case, to make competitive rates at any level of their own choosing if they exceed their out-of-pocket costs.

If the district court is correct, the financial health, vigor, and even the survival, of the various modes which comprise our national transportation system will be at the mercy of that mode which, because of the nature of its plant, operations, and traffic, has the lowest incremental cost, i.e., the railroads. Under the court's construction of the Interstate Commerce Act, a very substantial portion of the traffic presently handled collectively by a na-

[6] Various water carrier interests also intervened in support of the order of the Commission.

tional transportation system consisting of motor, rail and water carriers would be channeled exclusively to the railroads to the extent that they chose to move it at rates which returned only their out-of-pocket cost. Traffic would thereby be diverted from modes presently handling it at just and reasonable rates which allow for the profit necessary to sustain the national transportation system.

Since all costs are variable in the long run and must be recovered if an enterprise is to remain solvent, such a program would provide only a path to bankruptcy for any transportation system and all of its parts which followed it as a way of life. As we shall now show, this cannot be the law.

I

The district court's erroneous interpretation of the governing statutes is based on a number of invalid premises, the first of which involves a misreading of the legislative history of the Transportation Act of 1958.

A. In the 84th Congress, bills (H.R. 6141 and S. 1920) were introduced which proposed, among other things, a revision of the ratemaking section of Part I of the Act (§ 15a) to prohibit the Commission from determining, considering, or giving effect to the low-cost status of a competitive mode, or preserving the inherent advantage thereof. These bills died in committee.[7] H.R. 6141 included a proposed amendment of Section 15a of the Interstate Commerce Act to embrace the "three shall nots." These "shall nots" would have prohibited the Commission, in determining whether "a rate, fare, or charge, or classification, regulation, or practice to be applied in connection therewith, results in . . . less than a reasonable minimum charge" from considering "the effect of such charge on

[7] TRANSPORTATION POLICY, Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, April-June, 1956, 84th Cong., 2nd Sess. These are printed in three parts and extend through 1860 pages. H.R. 6141 is reproduced in Part 1 at pages 1-15.

the traffic of any other mode of transportation; or the relation of such charge to the charge of any other mode of transportation; or whether such charge is lower than necessary to meet the competition of any other mode of transportation . . .".[8] This proposal was endorsed by a witness appearing for the Association of American Railroads.[9]

In the 85th Congress, the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce issued a report in which it recommended the addition to Section 15a of a new paragraph (3) to read as follows:[10]

> In a proceeding involving competition with another mode of transportation, the Commission, in determining whether a rail rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by railroad *and not by such other mode.* (Emphasis supplied)

This stirred up such a storm of protest that, after additional hearings before the entire Committee at which the Chairman of the Commission registered its opposition to the proposal,[11] the Committee recommended the language finally enacted, which language not only eliminated the phrase "and not by such other mode," but added the last sentence in the subsection which requires that due consideration be given to the objectives of the National

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[8] *Id.*, p. 5.

[9] *Id.*, p. 548.

[10] PROBLEMS OF THE RAILROADS, Committee Print of Report of the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2nd Sess., p. 12.

[11] RATEMAKING RULE-ICC ACT, Hearings Before the Senate Committee on Interstate and Foreign Commerce, May 20-21, 1958, 85th Cong., 2nd Sess., on S. 3778, pp. 166-169.

Transportation Policy.[12] When section 15a(3) was cast in that form and enacted, Congress had before it the testimony of the then Chairman of the Commission that the phrase, ultimately discarded, "and not by such other mode," was objectionable because it "would enable the railroads to contend that it is intended to give them complete freedom, in the presence of competition from another mode of transportation, to establish rates which merely cover out-of-pocket costs" [13] and also his earlier testimony that "[f]or the purpose of ascertaining the most economical form of carriage, full costs should be the test." [14]

In *New Haven*, this Court thoroughly reviewed the 1958 Act and its legislative history and concluded that the railroad efforts in the 84th and 85th Congresses to secure legislation which would permit them to price competitive services on the basis of incremental costs, regardless of the effect on competitive carriers possessing the advantage of lower full costs, was abandoned by Congress because of the Commission's expressed fear that it would preclude the Commission from recognizing and preserving the inherent advantage of a competitive low-cost mode. This Court said:

> The principal purpose of the reference to the National Transportation Policy, as we have seen, was to prevent a carrier from setting a rate which would impair or destroy the inherent advantages of a competing carrier, for example, *by setting a rate, below its own fully distributed costs, which would force a*

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[12] TRANSPORTATION ACT OF 1958, Report of the Senate Committee on Interstate and Foreign Commerce on S. 3778, S. Rept. No. 1647, 85th Cong., 2nd Sess., June 3, 1958, pp. 2-4.

[13] Hearings, fn. 11, *supra*, p. 167.

[14] PROBLEMS OF THE RAILROADS, Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce, January-April, 1958, 85th Cong., 2nd Sess. The printed record is in four parts and contains 2355 pages. The testimony quoted was given on March 28, 1958, and is at p. 1839.

competitor with a cost advantage on particular transportation to establish an unprofitable rate in order to attract traffic. 372 U.S. 744, at 759. (Emphasis supplied)

The district court's decision does violence to the applicable legislative history and this Court's *New Haven* decision.

B. The district court's reliance [15] on the rejection by Congress of the Miller-Wadsworth amendment is misplaced. It is one thing to refuse to place the Commission in a ratemaking strait jacket which would prohibit it—under any circumstances—from approving a rate which returns less than the full cost of providing the service involved. It is quite another thing to adopt the reasoning of the district court, which seems to be that because Congress refused to place the Commission in the straight jacket referred to, it substituted still another, i.e., it took action to prevent the Commission—under any circumstances—from disapproving a rate which exceeds out-of-pocket (incremental) cost. The district court refers briefly [16] to some of Congressman Wolverton's remarks regarding the Miller-Wadsworth amendment. A broader reading thereof results in a better-focused legislative history. In his remarks on the amendment, the Congressman also said (86 Cong. Rec. 10191):

> The bill before us provides for fair and impartial regulation of all modes of transportation so that the inherent advantages of each will be recognized and preserved. There is no need for any amendment to give each form of transportation assurance on this point.
>
> The bill, as it stands, also fully protects one type of common carrier from unfair rate-cutting competition by another having higher costs. In the light of

[15] 268 F. Supp., at 82.

[16] *Ibid,* including the quotation from the Congressional Record in fn. 5 of the district court's decision.

> its provisions, the Interstate Commerce Commission could not permit such unfair or destructive competitive practices. Consequently, the Wadsworth amendment would contribute nothing in the way of safeguarding a carrier from unfair rate cutting but would create an unbearable and unjust burden upon shippers.
>
> * * * *
>
> Under the amendment Congress would prescribe a rigid rule to control the Interstate Commerce Commission's judgment concerning minimum rates. It has long been recognized that making freight rates by statute cannot be successful. Neither can regulation by arbitrary and inflexible ratemaking rules be successful. Flexibility and elasticity are as important to transportation price making as they are to price making in other industries, and rates cannot be made by formula, but must be regulated by the sound judgment of an administrative body.

The last-quoted portion of Congressman Wolverton's remarks make it crystal clear, we submit, that Congress, in rejecting the Miller-Wadsworth amendment, eschewed statutory ratemaking *of any kind*. It is, therefore, error to ascribe to such rejection any inference that Congress intended to depart from its traditional policy of allowing the Commission a considerable degree of "[f]lexibility and elasticity" in the field of "transportation price making." Yet that is precisely the intent which the decision of the district court imputes to Congress.

C. The support in the decided cases which the district court claims for its interpretation of section 15a(3) is simply not there. *Missouri P. R.R.* v. *United States*, 203 F Supp. 629 (1962), does not bear, even remotely, upon an inherent cost advantage as a relevant factor and yardstick in a rate case involving intermodal competition. This is because the Commission in that case did not deal with that circumstance.[17] *New Automobiles in Interstate Com-*

[17] The district court in the cited case held that "competition is destructive and unlawful . . . when . . . rates are so low as to

merce, 259 I.C.C. 475, (1945) is clearly inapposite. In that case the motor carriers did not seek the protection of an inherent cost advantage; rather, their contention in terms of costs, which the Commission rejected as constituting "umbrella" rate-making, was that the railroads' own full costs should be used as the floor for their competitive rates.[18] We call attention to these misreadings by the district court of the cases relied upon by it because they spotlight the failure of that court to resolve on a logical basis the substantial question of statutory interpretation which this case presents.

D. The district court was also in error in its preoccupation with only a portion of Section 15a(3) and the National Transportation Policy. The court focused on the provision in section 15a(3) that rates of one mode shall not be held up to a particular level "to protect the traffic" of another mode. But it ignored the requirement that "due consideration [be given] to the objectives of the National Transportation Policy." If this were a case in which the challenged rate was below railroad out-of-pocket costs, the Commission would undoubtedly have the power to require increases therein to a compensatory level, even though a collateral result would be to protect the traffic of the competing mode. Yet, under the theory of the district court, the Commission would have no such power so long as that would be a result of its action.

The district court concerned itself wholly with the requirement in the National Transportation policy that eco-

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deprive the competitor of his advantage of being the low cost mode." Neither the lower court nor the Commission reached the question of whether section 15a(3) permitted the application of that rule "because as indicated in the Commission's findings, 315 I.C.C., l.c. 16, the evidence 'does not permit a determination on this record of the low cost mode on this traffic . . .'". 203 F. Supp. 364-365.

[18] The Commission's order in the instant case would be contrary to *New Automobiles* only if $7.59 per gross ton, the railroads' full cost, had been prescribed as the floor for their competitive rate.

nomical and efficient service be promoted. It virtually ignored the requirement that the inherent advantages of the low-cost mode be preserved. Further, the district court proceeded on the theory that principles of economics claimed by some economists to chart the path to maximum profits in non-regulated industry should be the Commission's guide in dealing with the various segments of a wholly regulated industry, to the exclusion of all else. But the Commission must regulate as a "coordinator of different modes of transportation," to use the phrase by which this Court characterized its role under the National Transportation Policy in *Eastern-Central Motor Carriers Ass'n.* v. *United States*, 321 U.S. 194, 205-206 (1944). In that role the Commission cannot direct its whole attention, as the district court would have it, to a single mode.

It is not for the courts to say how the Commission should accommodate its regulation to the various requirements in the National Transportation Policy which may appear to overlap or even compete. This Court held in *McLean Trucking Co.* v. *United States*, 321 U.S. 67, 82 (1944), that the Policy "is the Commission's guide to 'the public interest' ", and that the Policy "demands" regulation so as "to recognize and preserve the inherent advantages of each" mode of transportation, in addition to a variety of other requirements. It is for the Commission, and not the courts, to determine what action on its part "will assist in affectuating the over-all transportation policy;" and resolving the many relevant considerations "is a complex task which . . . Congress left . . . to the Commission" (321 U.S., at 87).

In *Eastern-Central, supra*, this Court, after referring to coordination in accordance with the National Transportation Policy, said:

> This, while intended to secure the lowest rates consistent with adequate and efficient service and to preserve within the limits of the policy the inherent

> advantages of each mode of transportation, at the same time was designed to eliminate destructive competition not only within each form but also between or among the different forms of carriage. (321 U.S. at 206)

That objective is not accomplished when the Policy is construed, as it was by the district court, as evidencing the intent of Congress to give the railroads an unrestrained opportunity to maintain their rates on an incremental cost basis, regardless of the impact on the well-being of competitive forms which possess the inherent advantage of lower full costs.

The errors of the district court in holding that the Commission misinterpreted and misapplied the pertinent provisions of the governing statutes, both in its ultimate conclusion and in the premises on which that conclusion was based, are manifest. The need for a comprehensive and reasoned resolution of the issues by this Court in order to make clear the powers of the Commission in regulating intermodal competitive rates by the nation's surface transportation modes is so great that plenary consideration of this appeal is clearly warranted.

II

The district court held that the Commission failed to state a rational basis to support its use of fully-distributed cost to measure inherent advantage and as a foundation for preserving the inherent advantage so measured.

In view of the many prior pronouncements by the Commission of the principle here followed, it would have been enough if the Commission merely stated that it continued to follow its well-established policy for reasons articulated in its prior decisions, studies and reports to the Congress. See *J.H. Nowinsky Trucking Co.* v. *United States*, 195 F. Supp. 748, 751 (N.D. Wis., 1961); *Simpson* v. *United States*, 200 F. Supp. 372, 377 (S.D. Iowa,

1961), aff'd, 369 U.S. 526; Cf. *NLRB* v. *Seven-Up Bottling Co.*, 344 U.S. 344, 349 (1953).

In fact, in its reports in the instant case the Commission stated its reasons for rejecting the argument of the railroad economists and for choosing to stay with the full-cost basis for determining which of the competing transport modes possessed the inherent advantage which the National Transportation Policy requires it to recognize and preserve. After stating the argument of the four railroad economists, Division 2 found as follows:

> For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the Nation's transportation system is to be healthy. Thus, whenever competitive carriers of different modes assert cost advantages inherent to their respective modes, we have recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is reasonably practicable to apportion. Difficulties of apportioning constant costs do prevail. See *Grain in Multiple-Car Shipments—River Crossings to So.*, 321 I.C.C. 582, 597, reversed on other grounds in *Cincinnati, N.O. & T. P. R. Co.* v. *United States*, 220 F. Supp. 46 (S.D., Ohio 1963), appeal docketed, U.S. July 29, 1964, (No. 545). Since constant costs are not directly related to service units, they are assigned on an average statistical basis. In our opinion, however, that assignment does not detract from their worth. We adhere to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented. Stated differently, we recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced herein by respondents ignores them. We decline to so limit our ratemaking powers. (323 I.C.C. at 762-63; footnote omitted)

The entire Commission expressly stated that it agreed with the findings of Division 2 which analyzed the argument of the four economists. The district court completely ignored the above explanation, and instead quarreled with the merits of further findings of the entire Commission, which read:

> We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, does not necessarily mean that the carrier is the more efficient of the two. Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve. (326 I.C.C., at 82)

These findings clearly express the Commission view that to leave the high-cost mode free to make rates on the basis of out-of-pocket (incremental) costs would fail to preserve the inherent cost advantage of the low-cost mode, since the low-cost mode would thereupon be unable to compete on a rate level which would permit it to recover its full costs. The Commission reasoned that if the lower cost mode were forced to compete with rates of the high-cost mode at the level of the latter's incremental costs, the ability of the low-cost mode to continue in full vigor as a part of our national transportation system would be

impaired. If this were to happen, the Commission would not be able to coordinate its regulation of the competing modes so as to attain the objectives of the National Transportation Policy. These are rational reasons which are adequate under the requirements of the Administrative Procedure Act to support the Commission's order. This is particularly true in view of the railroads' complete failure to carry their burden of demonstrating that the Commission's long-established policy failed to properly measure the "inherent advantage" of low cost.

That a court may disagree with the Commission's analysis of complex accounting and economic issues, as did the lower court, is not enough to justify setting aside its order on the ground that it lacks a rational basis. As this Court said in *Chicago & N. W. R. Co.* v. *Atchison, T. & S. F. Ry.*, 387 U.S. 326, 356 (1967):

> Its [Commission's] factual findings and treatment of accounting problems concerned matters relating entirely to the special and complex peculiarities of the railroad industry. Our previous description of the Commission's disposition of these matters is sufficient to show that its conclusions had reasoned foundation and were within the area of its expert judgment. (Citations omitted)

CONCLUSION

The questions presented by this appeal are substantial and of public importance. For the reasons stated, it is urged that jurisdiction be noted and that the judgment of the District Court be reversed and the case remanded to that court for disposition consistent with the Court's opinion.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Peter T. Beardsley, one of the attorneys for appellants herein, and a member of the bar of the Supreme Court of the United States, hereby certify that, on the 9th day of November, 1967, I served copies of the foregoing document on the several parties hereto, in duly-addressed envelopes, with postage prepaid, as follows:

1. On Honorable Erwin R. Griswold, The Solicitor General, Department of Justice, Washington, D. C. 20530, and on Donald F. Turner, John H. D. Wigger, and Robert Johnson, Esqs., Department of Justice, Washington, D. C. 20530.

2. On Robert W. Ginnane, Esq., General Counsel, and Leonard S. Goodman, Esq., Assistant General Counsel, Interstate Commerce Commission, Washington, D. C. 20423.

3. On Harry C. Ames, Jr., Esq., 529 Transportation Building, Washington, D. C. 20006, J. Raymond Clark, Esq., 743 Investment Building, Washington, D. C. 20036, and A. Alvis Layne, Pennsylvania Building, Washington, D. C. 20004, counsel for appellant barge lines.

4. On Carl Helmetag, Jr., Esq., Six Penn Center Plaza, Philadelphia, Pa. 19103, Elbert R. Leigh, Esq., 908 West Broadway, Louisville, Ky. 40201, and Harry J. Breithaupt, Jr., Esq., 929 Transportation Building, Washington, D. C. 20006, counsel for appellees.

PETER T. BEARDSLEY

APPENDIX

NATIONAL TRANSPORTATION POLICY

[September 18, 1940.] [49 U. S. C., *preceding* §§ 1, 301, 901, and 1001.] It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

RULE OF RATE MAKING

Sec. 15a [February 28, 1920; amended June 16, 1933, September 18, 1940, August 12, 1958.] [49 U.S.C. § 15a.]

* * * *

(3) In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is

applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

ADMINISTRATIVE PROCEDURE ACT

Sec. 8 [June 11, 1946, amended September 6, 1966] [5 U.S.C. § 557]

* * * *

(c) Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions—

(1) proposed findings and conclusions; or

(2) exceptions to the decisions or recommended decisions of subordinate employees or to tentative agency decisions; and

(3) supporting reasons for the exceptions or proposed findings or conclusions.

The record shall show the ruling on each finding, conclusion, or exception presented. All decisions, including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of—

(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and

(B) the appropriate rule, order, sanction, relief, or denial thereof.

* * * *

Sec. 10 [June 11, 1946, amended September 6, 1966] [5 U.S.C. § 706] To the extent necessary to decision and when presented, the reviewing court shall decide all rele-

vant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

SUPREME COURT, U. S.
NOV 9 1967
JOHN F. DAVIS, CLERK

No. 808

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

THE AMERICAN WATERWAYS OPERATORS, INC.,
Appellant,

v.

LOUISVILLE and NASHVILLE RAILROAD COMPANY and PENNSYLVANIA RAILROAD COMPANY, ET AL., *Appellees.*

On Appeal From the United States District Court for the Western District of Kentucky at Louisville

JURISDICTIONAL STATEMENT

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STATUTE:

Interstate Commerce Act, 49 U.S.C. 1, *et seq.*, as amended by 54 Stat. 899 and 72 Stat. 572:	
Section 15a(3)	2
National Transportation Policy preceding 1, 301, 901, and 1001	2

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the District Court is reported at 268 F. Supp. 71. The final opinion of the Interstate Commerce Commission is reported at 326 I.C.C. 77, and the preliminary opinion of a division of the Commission is reported at 323 I.C.C. 758. These opinions appear in full in the appendices to the Jurisdictional Statement filed herein by appellant, American Commercial Lines, Inc., *et al.* The appendix page references in this statement are to those appendices.

JURISDICTION

This suit was brought in the District Court under 28 U.S.C. 1336 and 2321-2323 to set aside an order of the Interstate Commerce Commission. The judgment of the District Court setting aside the order was entered on May 15, 1967, and notice of this appeal was filed in the District Court on July 12, 1967. The time for docketing this appeal in this Court was subsequently extended to and including November 9, 1967, by successive orders of the District Court and this Court. The following decision sustains the jurisdiction of this Court to review this judgment on direct appeal, pursuant to 28 U.S.C. 1253 and 2101(b); *American Trucking Associations, Inc.* v. *United States,* 364 U.S. 1.

STATUTE INVOLVED

Section 15a(3) of the Interstate Commerce Act (49 U.S.C. 15a(3)), as amended by the Transportation Act of 1958, 72 Stat. 572, and the statement of National Transportation Policy (49 U.S.C. preceding 1, 301, 901, and 1001), 54 Stat. 899. As so amended, section 15a(3) provides that minimum rates "shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act." That policy states that the Act shall be "so administered as to recognize and preserve the inherent advantages of each" mode of transportation.

QUESTION PRESENTED

The notice of appeal states three questions which may be summarized in the following single question as to the Commission's power to preserve intermodal competition:

When the Commission finds that a rail rate has been reduced on traffic "of far more consequence to the barges than to the railroads" to a point where "all of the traffic would move by rail" and thus threatens the ability of the barges "not only to compete, but to exist" (App. 57, 53, 57), and further finds by a comparison of fully distributed costs that the barges are the low-cost carrier; may the railroads justify the reduction on the ground that the reduced rate exceeds their out-of-pocket costs.

STATEMENT

Introduction

Appellant is an association of shallow draft water carriers, which intervened in this case because of the threat to efficient bargeline transportation posed by an argument made by the railroad appellees. The railroads urged the Commission to hold that no reduced rail rate could be suspended as destructive of intermodal transportation competition, so long as the reduced rate exceeded rail out-of-pocket costs. This argument was substantially modified during the proceedings in the District Court and its opinion embraces an argument not made to the Commission. A review of the proceedings before the Commission and the District Court makes this fact apparent.

The Proceedings Below

The appellee railroads reduced their rate for carrying ingot molds from Pittsburgh, Pennsylvania, to Steelton, Kentucky, from $11.86 to $5.11 per ton. The Commission suspended the redueed rate because (1) it would divert all of this traffic from bargelines to the railroads (App. 53), (2) the traffic was of a class deemed essential to continued bargeline competition

(App. 57), (3) a comparison of fully distributed costs showed the barge movement to be the low-cost movement (App. 52), and (4) the reduced rate was below those costs for both rail and barge movements (App. 53). The railroads defended the reduction before the Commission on the sole ground that the $5.11 rate earned a profit for them on their out-of-pocket costs. They did not argue to the Commission that, in order to determine which intermodal competitor was more efficient, a comparison of out-of-pocket costs should be made instead of the full cost comparison made by the Commission.[1] Instead of urging a comparison of out-of-pocket costs on the Commission, the railroads presented testimony of four economists who said that the only economically sound method of regulating rail rate reductions was to let the rails reduce any rate to a point where it would yield a profit on their out-of-pocket costs. If it yields such a profit, these experts said it could not be a destructive rate; ergo, cost comparisons, either out-of-pocket or fully distributed, were irrelevant. Railroad self-interest and the transportation market would then determine which modes of transportation should survive.

The Commission rejected this limited view of its regulatory function in both its preliminary and final decisions. It held that, as to regulated carriers, a comparison of their fully distributed costs should determine which mode of transportation was more efficient. The low-cost carrier would then be eligible to

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[1] The Commission decision notes:

> It is respondents' position that only out-of-pocket (incremental) costs of the proponent carrier should be considered, and that a rate which exceeds such costs is lawful. In their view no reliable intermodal cost comparison can be made and none should be attempted (App. 52).

receive Commission protection against a rate cut which threatened to deprive the more efficient mode of its inherent cost advantage. Although Division 2 of the Commission held that such protection had been waived when the bargeline quoted a rate slightly below its own fully distributed cost, the Commission at every stage of the proceding accepted fully distributed costs as the costs to be compared. This was the position maintained by the Solicitor General and the antitrust division of the Justice Department in *Interstate Commerce Commission* v. *New York, N. H. & H. R.R. Co.*, 372 U.S. 744, hereafter referred to as *New Haven*.[2]

In the District Court the antitrust division reversed its *New Haven* position and confessed error on the Commission. The division was apparently persuaded by the railroads' argument that the 1958 amendment to the Interstate Commerce Act was intended to substitute free market competition for Commission regulation as a means of insuring the survival of efficient intermodal transportation competition. The antitrust division argued in the District Court, however, that the Commission had authority to insure the survival of intermodal competition by suspending a rail rate-cut, providing that a comparison of out-of-pocket costs showed that the competing mode, whose traffic was being pre-

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[2] The Summary of Argument in the brief for the United States in *New Haven* said at p. 15:

> To warrant protective action it must be shown not only that the competing carrier possesses an inherent cost advantage, but also that this advantage would be impaired by the proponents' rate. Such impairment occurs, we submit, when the low-cost carrier is unable to fix a rate which (a) covers its fully distributed costs and (b) affords it a rate advantage (as against the high-cost carrier) which is no less than the cost differential (measured in terms of fully distributed costs) between the two modes.

empted by the cut, had the lower out-of-pocket costs in carrying it.[3] In the District Court an issue not before the Commission was thus joined as to whether a full cost or out-of-pocket cost comparison should be used to determine the more efficient mode.

The District Court's Decision

The District Court's opinion unequivocally holds that the Commission's decision violates the law and has no rational basis. The Court's judgment permanently enjoins enforcement of the Commission's order. The Court apparently interpreted the statute in a way which does not leave the Commission free to sustain its order by clarifying or supplementing its findings. While complaining that the Commission failed to support its conclusion that fully distributed costs should be compared, the Court fails to note that the Commission was not asked to use any other comparison to determine the low-cost mode. Had an argument in favor of an out-of-pocket cost comparison been presented to it, the Commission might have found that such a comparison with rail carriers would generally exclude from the low-cost designation the more efficient, specialized carriers, such as bargelines, whose fully distributed and out-of-pocket costs on the limited classes of traffic they carry are virtually the same. The Commission might also have countered such an argument by pointing out that a railroad may destroy a competing mode by cutting rates on such limited classes of traffic to a point just above out-of-pocket costs and relying upon higher rates prevailing on its other traffic to cover

[3] The Reply Brief for the United States submitted to the District Court in this case asserts that ". . . the mode which has the lowest intermediate-long range out-of-pocket cost for a particular service is the most efficient mode to provide that service" (pp. 5-6).

the full cost of operating a railroad. The court's opinion, therefore, seems to hold that, in the circumstances of this case, the Commission is barred from using a full cost comparison, as a matter of law.

The Court below also erroneously assumed that the Commission was trying "to prevent any rate competition which threatens the existence of a competitor" (App. 14). The Commission did find that the rate-cut in question threatened the continued existence of barges as railroad competitors (App. 57, 60). But the Commission also showed by a detailed comparison of fully distributed costs that the barges were the lower cost mode and that the rail rate was cut below the full costs of the railroad as well as below the full costs of the barges. The Court's assumption that the purpose of the Commission's suspension was not to "prevent destructive competition" (App. 11) mistakenly assumes that elimination of a more efficient competing mode by below cost rate cutting is not destructive competition.

The Court below announced the proposition that "compensatory rates should normally be allowed" (App. 20) without any discussion of the precise costs that should be allowed to enter the computation of a compensatory rate. It rejects established Commission formulae for determining compensatory rates and holds that any rail rate exceeding "relevant out-of-pocket costs" (App. 20) should be regarded as compensatory in determining the low-cost mode. The Court's decision is thus a flat refusal to permit the Commission to discharge its statutory duty to preserve intermodal competition by suspending a rail rate which undercuts both fully compensatory rail costs and the costs actually incurred by barges in hauling more efficiently the traffic that the cut rate preempts for the railroads.

THE QUESTION INVOLVED IS SUBSTANTIAL

This appeal raises the fundamental question of what facts the Commission must find to justify suspension of a rail rate which threatens to eliminate the competition of a more efficient mode of transport. It seems beyond dispute that the 1958 amendment was intended to give the railroads more flexibility in meeting intermodal competition while retaining in the Commission the power to suspend rail rates which threaten to destroy more efficient competitors. In *New Haven,* this Court exhaustively considered that amendment and affirmed the Commission's continuing duty to deal with this problem in a flexible fashion, without supplying explicit guidelines. The District Court has now decided that the factors normally relied upon by the Commission to justify suspension of a rail rate that threatens to destroy intermodal competition are irrational considerations, unsupported by the Act it administers. The Commission is told only that compensatory rates should normally be allowed without any explanation of why the circumstances found by the Commission here did not justify the suspension ordered.

If the facts found by the Commission here, to wit, lower full costs of barges and threatened destruction of the barges as competitors for the traffic, do not justify suspension of a rail rate cut below both the rails' and the barges' full costs, what facts would justify suspension of a rail rate to preserve intermodal competition?

New Haven appeared to give the Commission a range of discretion in dealing with this problem that the District Court now says the Commission does not have. Unless this Court reaffirms its *New Haven* decision that the Commission, not the courts, must select the cost comparisons needed to preserve efficient intermodal competition, the Commission is helpless to dis-

charge its obligation to prevent destruction of such competition by railroad rate cuts.

CONCLUSION

This Court should review and reverse the District Court's decision. The question raised is important and an authoritative answer is needed by the railroads, the bargelines, and every transportation company subject to Commission jurisdiction.

It is, of course, unfortunate that the Commission was given no opportunity to consider the out-of-pocket cost comparison argument ultimately presented to the District Court. If this Court concludes that plenary consideration should be deferred until the Commission has had an opportunity to address its findings specifically to the relative merits of fully distributed and out-of-pocket cost comparisons in cases such as this one, the decision below should be summarily vacated and the case remanded to the Commission for performance of this task.

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No. 809

In the Supreme Court of the United States

OCTOBER TERM, 1967

INTERSTATE COMMERCE COMMISSION, APPELLANT
v.
LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY.

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the district court (App. 1–21)[1] is reported at 268 F. Supp. 71. The report of the entire Interstate Commerce Commission (App. 49–69) is printed at 326 I.C.C. 77. An earlier report of the Commission, Division 2 (App. 24–48), is printed at 323 I.C.C. 758.

JURISDICTION

This action was brought under 28 U.S.C. 1336, 1398, 2284, and 2321–2325, to set aside an order of the In-

[1] "App." followed by a number refers to a page in the Appendix to the Jurisdictional Statement filed on behalf of the American Commercial Lines, Inc., and other water carriers, as separate appellants herein.

terstate Commerce Commission. The final judgment of the three-judge district court (App. 22–23) was entered on May 15, 1967. The Commission filed a notice of appeal on July 13, 1967; and the time for docketing the appeal was extended by District Judge Gordon until October 13, 1967. Subsequently, Mr. Justice Stewart entered an order further extending the time for docketing the appeal to and including November 9, 1967.

The jurisdiction of this Court to review the judgment of the district court on direct appeal is conferred by 28 U.S.C. 1253 and 2101(b). *American Trucking Associations, Inc.* v. *Atchison, Topeka and Santa Fe Ry. Co.*, 387 U.S. 397; *American Trucking Associations, Inc.* v. *United States*, 364 U.S. 1.

STATUTE INVOLVED

Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. 15a(3), provides:

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

The National Transportation Policy, 49 U.S.C. preceding §§ 1, 301, 901 and 1001, provides:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

QUESTIONS PRESENTED

The Interstate Commerce Commission found that the substantially reduced rate filed by certain railroads to capture traffic being handled in a joint barge-truck service, impaired the latter mode's inherent advantage of low cost, determined by comparison of fully distributed costs, in violation of the National Transportation Policy, *supra*. Although higher than the railroads' out-of-pocket cost of performing the

service, the reduced rate was filed at a level below the barge-truck fully distributed or average costs. The district court held that Section 15a(3) of the Interstate Commerce Act, *supra,* and the National Transportation Policy required the Commission as a matter of law to permit such a reduction. It further held that the Commission had not sufficiently explained and justified its use of a full-cost standard. The questions presented are, (1) whether the statute requires the Commission normally to allow railroads to reduce their rates to an out-of-pocket level in competition with bargelines; and (2) whether the Commission's reliance on a full-cost comparison was justified in the circumstances of the present case.

STATEMENT

With a tariff filed to become effective December 1, 1963, the Louisville and Nashville Railroad Company and the Pennsylvania Railroad Company proposed to reduce their rate on ingot molds and stools moving from Pittsburgh, Pa., to Steelton, Ky., 57 percent from $11.86 per ton to $5.11 per ton. The stated purpose of the reduction was to capture traffic that was then moving via a combination of barge and truck service at the rate of $5.11 per ton (App. 2 and 25–26). It was undisputed that at equal rates all such traffic would move by rail (App. 53).

The Commission suspended the proposed reduction for the full statutory period of seven months. The Commission did not conclude its proceedings and enter a final order within the seven-month period; the reduced rate, therefore, became effective on March

19, 1965, at the expiration of that period by operation of law, following a voluntary extension of the period.

At the hearing before a hearing examiner of the Commission, the railroads presented evidence that the proposed rate of $5.11 was substantially below their "fully-distributed costs" (computed by them at $7.59), but exceeded their "long-term out-of-pocket costs" (computed by them at $4.83). The railroads further presented the opinion testimony of four economists that, (1) the railroads would in general make greater profits by reducing some rates below their fully-distributed costs (but above out-of-pocket costs) when necessary to attract traffic; and (2) the railroads with their heavy fixed investments operate more efficiently when given this freedom to price their services at different price levels for different customers depending upon the value of the service. These witnesses stated that no comparison of water and rail costs should deprive the railroads of this opportunity to maximize their own profits.

The protesting barge lines, separate appellants herein, presented evidence that their fully-distributed costs, including a loading and unloading charge borne by the shipper-consignee, was $5.19 or a few cents more than the existing barge-truck rate. These water carriers showed that the instant traffic was one among a limited number of commodities handled by them; and further presented the opinion testimony of a transportation economist that water carriers must recover their full costs in order to survive.

A division of the Interstate Commerce Commission, composed of three members of the Commission,

accepted the parties' computation of their own costs (App. 27–28). The Division then held that the barge-truck mode possessed an inherent cost advantage over the railroads, based on a comparison of the full costs, but added (at 30–31) that in their opinion the advantage and the concomitant protection of the National Transportation Policy had been lost by the water carriers when their rate was voluntarily set at a level of a few cents below their full costs (App. 24–48; 323 I.C.C. 758).

Following the petition for reconsideration filed by the barge interests, and a petition and reply of the railroads, the entire eleven-member Commission entered the report of November 9, 1965, with two of the former members of Division 2 and one other Commissioner dissenting. The Commission concluded that a decision regarding the inherent advantage of low cost first requires "a comparison of the cost advantages of two competing modes of carriage." The question cannot be determined "*in vacuo,* by viewing the operations of a single carrier or mode, as urged by the respondents [the railroads]." (App. 54).

The entire Commission then agreed with the Division that the barge-truck mode possessed an inherent cost advantage based on a comparison of the full costs of that mode with the full costs of the railroads. The Commission found that the railroads had failed to show their service to be more efficient than the barge-truck service. "Merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully-distributed costs" may mean that such carrier will make greater profit than if it

did not handle the traffic, but "does not necessarily mean that the carrier is the more efficient of the two" (App. 56–57).

In such circumstances, "the Commission consistently has utilized the fully-distributed cost standard," and "under that standard the rail respondents here do not possess an inherent cost advantage." (App. 59).

The Commission added that the propriety of using that standard in the future either as a rule or on a case-by-case basis, was pending in another proceeding (App. 59).[2] "A radical departure from the fully-distributed cost norm as urged by the respondents would not be justified on the limited record here before us, particularly when such issues are to be determined on a comprehensive record in docket No. 34013." (*Ibid.*)

The entire Commission held that an inherent advantage cannot be lost by mistake or inadvertence, and is entitled to protection under the National Transportation Policy (App. 57–58). The Commission, with three dissents, thereupon reversed the Division and

[2] Besides finding no basis on the present record for departing from precedent, the Commission also stated that on the facts before it a fully-distributed cost standard would be more "fair" and "impartial" within the meaning of the National Transportation Policy. "The traffic here involved is of far more consequence to the barges than to the railroads. * * * [I]ron and steel products, which includes ingot molds, is the third most important commodity group transported in barge service, accounting for 10.81 percent of their total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of the total barge revenue." The railroad's concept of "inherent cost advantage" under the Policy "would impair the ability of a carrier not only to compete but to exist." (App. 57).

ordered the rail tariffs cancelled (App. 49–69; 326 I.C.C. 77).

The district court at the suit of the railroads entered an opinion and judgment permanently enjoining the order of the entire Commission. The Department of Justice had in the meantime filed an answer supporting the plaintiff railroads; it urged the court on brief (p. 26), that the determination of inherent advantages under the statute must be left to the "judgment of the marketplace, as is normally the case in a free enterprise system," and a comparison of cost and service advantages is "not a relevant element of the rate proceedings."[3]

The district court held, first, that the burden was on the Commission to justify its use of a fully-distributed cost standard. The court would remand for "some explanation *why the standard* chosen by the Commission *measures* which carrier is more efficient in providing the service here involved" [emphasis theirs] (App. 9). But, regardless of the adequacy or inadequacy of the Commission's findings justifying its use of a fully-distributed cost standard, the lower court would nevertheless have remanded. As the court states, "It is our belief that the Commission's order

[3] The position represented a reversal of the position stated by the United States in *Interstate Commerce Commission* v. *New York, N.H. & H.R. Co.*, No. 108 (Oct. Term 1962), reported at 372 U.S. 744 and cited herein as the *New Haven* case. There the Department argued on brief that a proposed rate destroys a cost advantage "when the low-cost carrier is unable to fix a rate which * * * covers its fully distributed costs * * *" (p. 40–41). The Department would have required a rate differential based on the difference in the fully-distributed costs of the two competing modes (at 15, and 40–41).

is based upon a misinterpretation or misapplication of the relevant statutory provisions" (App. 14).

The lower court states "that the underlying purpose of Congress in enacting Section 15a(3) was to direct the Interstate Commerce Commission to observe the original intent of Congress in 1940 and to restore and adhere to the policy set forth in *New Automobiles*[4] with respect to the preservation of inherent advantatges" (App. 15). This twofold purpose of Congress in enacting Section 15a(3) means to the lower court "that carriers should normally be free to offer rates which are compensatory, *i.e.*, above relevant out-of-pocket costs" (App. 20). As a matter of law, in its view, "the National Transportation Policy would not prevent carriers from establishing rates which exceeded out-of-pocket costs in the kind of situation here presented" (App. 16).

THE QUESTIONS ARE SUBSTANTIAL

In ruling that, as a matter of law, the Commission is normally powerless to interfere with proposed railroad rate reductions to the level of their out-of-pocket costs, an indicium most favorable to the railroads when competing with barge lines, the lower court misreads Section 15a(3) and its legislative history, as well as this Court's *New Haven* decision analyzing both at length. Hence, this Court again is asked to address itself to "but another episode in the long and continued struggle between the railroads and competing barge lines." *Mechling Barge Lines* v. *United States*, 376 U.S. 375, 376.

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[4] *New Automobiles in Interstate Commerce*, 259 I.C.C. 475 (1945).

1. The lower court interprets Section 15a(3) of the statute as giving everything to the railroads that years of effort failed to attain, namely, a rule of law allowing them to reduce their rates to an out-of-pocket level to capture the traffic of a competing water carrier. This Court reviewed the legislative history of Section 15a(3) in detail in *Interstate Commerce Commission* v. *New York, N.H. & H.R. Co.*, 372 U.S. 744. This Court specifically noted that Congress had decided against a rule of law that would have rendered the Commission "powerless to reject a railroad rate which covered the railroad's out-of-pocket costs, even if that rate had the effect of destroying the inherent advantages of a lower-cost carrier" (at 755).

This Court expressly reserved decision in *New Haven* on which cost measure should be used to decide the question of inherent advantage (at 760); but in so doing it made clear the Commission was not precluded from using a full-cost standard. On the contrary, noting that Representative Harris in this connection had referred to a rate that was "fully compensatory" (at 757), this Court added:

> the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed cost and thus perhaps to go out of business (at 758). [Emphasis as stated in the opinion.]

The *New Haven* opinion properly, we believe, treats the question of inherent advantage as one within the primary jurisdiction and discretion of the Commission. It is a question of "utility," a question of which measure may be "preferred for comparing the costs of two or more modes of transportation." (at 760, note 13). The lower court, however, rigidly frames its norm as a statutory mandate; and deprives the Commission of discretion to develop a standard or even to respond to the particular circumstances of a given case. Under the ruling of the lower court, the Commission is precluded under any circumstances, including the broader investigation now pending, from disapproving any rate that is above the out-of-pocket costs of the proponent mode even though another mode's inherent advantage of low cost is thereby impaired. We submit the lower court must be reversed for the Commission to regain its primary jurisdiction in this area.

2. The lower court states that Congress by enacting Section 15a(3) in 1958 directed the Commission "to observe the original intent of Congress in 1940" when it enacted the National Transportation Policy (App. 15);[5] the court then proceeds to misread the history

[5] The lower court also refers to the decision in *New Automobiles*, *supra*, to support its out-of-pocket rule. The *New Automobiles* decision involved rail reductions to meet motor carrier competition. The decision on its face shows that the motor carriers there did not assert an inherent advantage of low cost, but rather sought to save their revenues "from further depletion, and to prevent the extinction of the motor common carriers" (259 I.C.C. at 530). The Commission simply held, "there appears no warrant for believing that rail rates * * * should be held up to a particular level to preserve

of that Policy as favoring an out-of-pocket rule of law.

Representative Lea, Chairman of the House Committee which heard the bill and Chairman of the House conferees, specifically requested the views of the Commission on a bill that would have required the Commission to "give due consideration to the undesirability" of allowing any carrier to establish rates below "full costs" where "such rate * * * is maintained to meet competition."[6] Commissioner Eastman responded in a letter of March 20, 1939, that the Commission would prefer no statutorily prescribed cost standard in the absence of "sufficient experience in fixing minimum rates." He suggested that Congress "for the present * * * permit the Commission to be guided in this respect by the general rate-making rules * * * and by the general declaration of policy."[7]

So strong was the Congressional belief that the railroads might be favored by the Commission over the water carriers, that both houses of Congress in the so-called Miller-Wadsworth amendment would have required that the Commission permit reduced rates *only*

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a motor-rate structure, or vice versa" (at 538). *New Automobiles* was cited by Congress in 1958 only for the proposition that rail rates should not be held up to preserve a motor-rate structure. See *New Haven* case, 372 U.S. at 757; and see S. Rep. No. 1647, 85th Cong., 2d Sess., p. 3 (1958); H. Rep. No. 1922, 85th Cong., 2d Sess., p. 14 (1958).

[6] H.R. 2531, 76th Cong., 1st Sess., sec. 41.

[7] Letter from the Chairman of the Legislative Committee, Interstate Commerce Commission, to the Chairman of the Committee on Interstate and Foreign Commerce, House Committee Print, 76th Cong., 1st Sess., p. 7 (1939).

to the extent the reductions covered full costs.[8] The conferees opposed such an inflexible rule of law, and it was not enacted.[9] The Congressional rejection of a full cost rule of law for all cases cannot be read, contrary to the opinion below (*e.g.* App. 19–20), as the positive enactment of an equally inflexible out-of-pocket rule of law.

Although Congressman Wolverton, one of the conferees, spoke against the Miller-Wadsworth amendment (See App. 20), he added, "The bill, as it stands, also fully protects one type of common carrier from unfair rate-cutting competition by another having higher costs."[10] Far from believing "that such a restriction on competition would be extremely undesirable" (App. 20), Congress intended the National Transportation Policy to protect the water carriers from rate-cutting that deprived them of an inherent advantage of lower costs. As Congressman Halleck stated, the statutory reference to "inherent advantages,"

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[8] See, *e.g.*, the remarks of Senator Miller who sponsored the amendment in the Senate, 84 Cong. Rec. 5881. The text of the amendment is set forth in the opinion below (App. 19, note 5).

[9] The amendment was adopted both in the Senate (84 Cong. Rec. 6074) and in the House (at 9977); but the conference committee refused to report it out of conference. The conferees recognized that many rates on bulk commodities (grain, coal, etc.) were set below a full cost level, since those commodities would not move at the higher rate level. 86 Cong. Rec. 10179, remarks of Congressman Lea; *id.* at 10191, remarks of Congressman Wolverton; H. Rep. No. 2832, 76th Cong., 3d Sess., p. 87 (1940). The amendment, therefore, would have required increases in many existing rates that were pegged at the lower level for reasons entirely unrelated to the inherent advantages of competing modes of transportation.

[10] 86 Cong. Rec. 10191.

> means a recognition of the rights of the country to cheap and economical transportation by water, that there are certain advantages inherent in that type of transportation and that these advantages shall be preserved to the people of this country.[11]

3. In *New Haven,* this Court reviewed in detail the history of Section 15a(3) and the Congressional rejection of the rule of law adopted below. Congress rejected the "three-shall-nots," first proposed in 1955, since the Commission had "expressed concern * * * it would be powerless to reject a railroad rate which covered the railroad's out-of-pocket costs, even if that rate had the effect of destroying the inherent advantages of a lower-cost carrier." (372 U.S. at 754–55). The Commission was not to be required to accept a railroad's showing of out-of-pocket costs as foreclosing further inquiry into which carrier possessed an inherent advantage of lower costs; as the Commission had stated before Congress, "in many instances * * * the full cost of the low-cost form of transportation exceeds the out-of-pocket cost of another." (372 U.S. at 755).

4. The lower court also found error in the Commission's findings regarding how or why the full-cost standard measures the inherent advantage of low cost.[12] The railroads made the present record

[11] 84 Cong. Rec. 9711.

[12] The court below also questions whether it is "unrealistic in comparing the relative efficiency of the two modes" to include an apportionment of the passenger and less-than-carload deficits in the computation of rail full costs (App. 9). This Court has held that the Commission reasonably includes this cost of doing rail business in the computation of full costs (*King* v. *United*

before the Commission seeking to establish the principle, since abandoned before the lower court,[13] that the Commission should not compare railroad costs with the costs of any other mode.[14] Rather than make a frontal attack on the full-cost standard theretofore used by the Commission, the railroads urged, (1) they would operate more profitably if allowed to reduce rates to an out-of-pocket level whenever necessary to meet competition; and (2) they would make greater and more economic use of their own resources if allowed to make such reductions. Their witnesses made no effort to compare the relative performance of rail versus water carriage, nor to measure the relative efficiency of the two modes in performing the same transportation service. The Commission properly responded in these circumstances that there was no showing before it that the railroads were "more efficient" than the competing barge lines (App. 56–57), and hence the Commission would adhere to its prior

States, 344 U.S. 254, 266–67); a witness for the railroads stated the same thing (Exh. 38, p. 23); but in any event these deficits here amounted to less than 67 cents out of the rail full cost of $7.59, and their omission would not have changed the result.

[13] Compare the opening Brief of the Railroads in the district court (p. 18) with the Reply Brief of the Railroads (p. 8).

[14] See Exh. 37, pp. 5, 12–16, 25, Att. p. 9; Exh. 38, pp. 18–21, 22–23, 30; Exh. 39, pp. 17–19; Exh. 40, p. 7. Although the last railroad witness conceded that railroads uniquely have excess capacity (Exh. 40, p. 4), he also stated (at 8), uniquely among the witnesses (*e.g.* compare Exh. 38, pp. 20–21, 27–28), that, "where the intermediate long-run incremental cost of another transport industry is above that of railroads (for service of equivalent quality) that other industry is not as economically efficient as the railroads."

use of fully-distributed costs since a "radical departure" has not been "justified on the limited record here before us" (App. 5).

The proceeding below was not the first to be decided under Section 15a(3) following this Court's decision in *New Haven*. In each case, the Commission decided the issue of inherent cost advantage on the basis of fully-distributed costs.[15] We submit that the railroads bore a burden, which they failed to carry, of proving to the Commission that their proposed measure of the inherent advantage of low cost better tested the relative efficiency of competing modes than the established standard.[16] The Commission's summary rejection of an out-of-pocket standard in these circumstances was fully justified.

CONCLUSION

The lower court's rule of law deprives the Commission of its primary jurisdiction to protect and preserve

[15] *Pig Iron, Buffalo, N.Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121, 128–30 (1963); and cases cited by the entire Commission in its present report, App. 59.

[16] See and *cf. New Haven*, 372 U.S. at 760, note 12; *Brotherhood of Maintenance of Way Employes* v. *United States*, 221 F. Supp. 19, 28 (E.D. Mich. 1963), aff'd per curiam 375 U.S. 216; *Brotherhood of Locomotive Engineers* v. *United States*, 217 F. Supp. 98, 103 (N.D. Ohio 1963). In *New Haven*, the Supreme Court admonished that the proponent of a rate (here the railroads) should show the proposed rate to be compensatory, and it would be for the protesting carrier to persuade the Commission of the existence of an inherent cost advantage. We submit that when the protesting carrier shows the existence of an inherent cost advantage in terms of the existing measure employed by the Commission the burden then shifted to the railroads, seeking to upset that measure, to convince the Commission of the existence of a yardstick of greater "utility."

the inherent advantage of low cost as between competing modes of transportation. The Commission's findings adequately explain its rejection of an out-of-pocket cost yardstick, for comparing the two modes, particularly in view of the limited record before it and the current pendency of its broader investigation in Docket No. 34013.[17]

Probable jurisdiction should be noted and the judgment below reversed.

Respectfully submitted.

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NOVEMBER 1967.

[17] The Commission in the present proceeding expressly referred to *Rules to Govern the Assembling and Presenting of Cost Evidence*, Docket No. 34013, as the proceeding in which it would give more precise consideration to the measure of inherent cost advantage (App. 59).

U.S. GOVERNMENT PRINTING OFFICE: 1967

SUPREME COURT, U. S.
DEC 1
JOHN F. DAV

Nos. 797, 804, 808, and 809

In the Supreme Court of the United States

OCTOBER TERM, 1967

AMERICAN COMMERCIAL LINES, INC., ET AL., APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL., APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

THE AMERICAN WATERWAYS OPERATORS, INC., APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

INTERSTATE COMMERCE COMMISSION, APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

MEMORANDUM FOR THE UNITED STATES

ERWIN N. GRISWOLD,
Solicitor General,
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Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 797

AMERICAN COMMERCIAL LINES, INC., ET AL., APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

No. 804

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,

APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

No. 808

THE AMERICAN WATERWAYS OPERATORS, INC.,

APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

No. 809

INTERSTATE COMMERCE COMMISSION, APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

MEMORANDUM FOR THE UNITED STATES

These are appeals by the Interstate Commerce Commission (No. 809) and certain barge (Nos. 797 and 808)

and trucking (No. 804) interests from the decision of a three-judge district court (J.S. No. 797, App. A, B) which set aside the Commission's decision in Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77. The Commission proceeding was an investigation of a reduction in the rates charged by the Louisville and Nashville Railroad and the Pennsylvania Railroad for the carriage of ingot molds over a particular Pennsylvania-Kentucky route. The railroads compete against a combined barge and truck service for this traffic, and certain barge lines protested the reduction.

Although the reduced rate is above the railroads' out-of-pocket costs incident to handling the traffic, the protestants claimed that it was illegal because it was below the fully distributed costs of the barge and truck lines for their similar service. The question is governed by Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. 15a(3), which provides that "rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy * * *." That policy requires that the Interstate Commerce Act be "so administered as to recognize and preserve the inherent advantages of each [mode of transportation]." 49 U.S.C. preceding Section 1. The Commission concluded that to determine which mode of transportation possesses the "inherent advantage," it must compare the fully distributed costs of each mode. It then held that the mode with the lowest fully distributed costs has the inherent advantage and that, to

preserve it, competing modes should be prohibited from offering reduced rates which are below this level. Hence, it found that the railroads' reduced rates were unlawful even though—since they covered out-of-pocket costs—they were compensatory.

The railroads then brought the instant action for review of the Commission's order in the district court. The United States, a statutory defendant, filed an answer admitting the allegations of the complaint and thereafter participated as a plaintiff. Forty-eight railroads intervened in support of the plaintiff railroads; various barge lines, motor carriers, and their trade associations intervened in support of the Commission. The court below set aside and enjoined the Commission's order, and remanded the matter for reconsideration (J.S. App. 22–23). It held that the Commission had failed to state a rational basis to support its adoption of comparative fully distributed costs as the test of inherent advantage among competing modes of transportation (J.S. App. 7); and that when Congress adopted Section 15a(3) in 1958, it expressed a clear intent that compensatory rates—*i.e.*, rates above the out-of-pocket costs of one mode but below the fully distributed costs of another—should normally be allowed notwithstanding their impact on competing modes (J.S. App. 14–21).

The appeals present a major issue reserved by this Court in *Interstate Commerce Commission* v. *New York, New Haven & Hartford R. Co.*, 372 U.S. 744, 760–761—whether out-of-pocket costs, fully distributed costs, or "some different measure" should be the criterion for determining which mode of transporta-

tion has the inherent advantage under Section 15a(3) and the National Transportation Policy.[1] The obvious importance of the question to the future regulation of inter-modal competition under Section 15a(3) of the Interstate Commerce Act and the National Transportation Policy suggests the appropriateness of plenary consideration. We therefore urge this Court to note probable jurisdiction.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

DECEMBER 1967.

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[1] Although the district court's first ground of decision does not reach this question, it is necessarily presented because the second ground—that the Commission misinterpreted or misapplied the relevant statutory provisions (J.S. App. 14)—prohibits the Commission, except in extraordinary situations, from using fully distributed costs as the criterion for determining inherent advantage between competing modes.

U.S. GOVERNMENT PRINTING OFFICE: 1967

Nos. 797, 804, 808, 809

IN THE

Supreme Court of the United States

October Term, 1967

AMERICAN COMMERCIAL LINES, INC., et al.,
Appellants in No. 797

AMERICAN TRUCKING ASSOCIATIONS, INC., et al.,
Appellants in No. 804

THE AMERICAN WATERWAYS OPERATORS, INC.,
Appellant in No. 808

INTERSTATE COMMERCE COMMISSION,
Appellant in No. 809

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, et al.,
Appellees

On Appeal From the United States District Court for the Western District of Kentucky

MOTION TO AFFIRM

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Nos. 797, 804, 808, 809

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

AMERICAN COMMERCIAL LINES, INC., ET AL.,
Appellants in No. 797

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,
Appellants in No. 804

THE AMERICAN WATERWAYS OPERATORS, INC.,
Appellant in No. 808

INTERSTATE COMMERCE COMMISSION,
Appellant in No. 809

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.,
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

MOTION TO AFFIRM

Pursuant to Rule 16, paragraph 1(d) of the Rules of this Court, the appellee railroads[1] move that the judgment of the District Court be affirmed.

1. The appellee railroads include the Louisville and Nashville Railroad Company and The Pennsylvania Railroad Company, complainants below, and 48 other Class I railroads which were permitted to intervene in support of the complainants. See Brief of Railroads in court below, at p. 59, for list of interveners.

STATEMENT

Involved are four appeals from a judgment [2] of a three-judge district court entered on May 15, 1967, pursuant to its opinion in *Louisville and Nashville Railroad Co. v. United States*, 268 F. Supp. 71 (W.D. Ky. 1967).[3] In its opinion, the court below, without dissent, set aside an order of the Interstate Commerce Commission in *Ingot Molds, Pa., to Steelton, Ky.*, 326 I.C.C. 77 (1965) [4] and remanded the matter to the Commission "for reconsideration and such further action as the Commission may deem appropriate, not inconsistent with the opinion this day reached by this court." [5]

In the order which accompanied its report, the Commission required the railroads to cancel a reduced rate of $5.11 per ton on ingot molds moving in multiple car shipments from Neville Island and Pittsburgh, Pa. to Steelton, Ky., even though the Commission had found that the rate was at the same level as the charge of the competing barge-truck route; [6] that it was required by the railroads if they were to effectively compete; [7] that it ceeded by a substantial margin the railroads' out-of-pocket costs of $4.689 —*i.e.*, all of the expenses incurred by the railroads in pro-

2. Jur. St. in No. 797 at App. 22-23.

3. Jur. St. in No. 797 at App. 1-21.

4. Jur. St. in No. 797 at App. 49-69. It should be noted that three commissioners, Vice Chairman Bush, Commissioner Freas and Commissioner Tierney, dissented in three separate dissenting opinions, 326 I.C.C. at 85-86, 86-90, 90-91; and that Division 2 of the Commission, which first considered the lawfulness of the reduced rate, approved it without dissent, Ingot Molds, Pa., to Steelton, Ky., 323 I.C.C. 758 (1965).

5. Jur. St. in No. 797 at App. 22.

6. 326 I.C.C. at 78-79.

7. *Id.* at 78.

viding the service,[8] computed by the Commission's own formula—and therefore was both compensatory and profitable; and, that it would maximize the amount available to meet the railroads' constant expenses.[9] There was no finding by the Commission that this constructive pricing adjustment, which affords the shipper the choice of two competing services at the same price, was discriminatory or unlawful by any standard regularly used by the Commission in judging the reasonableness and lawfulness of carrier rates.[10]

The Commission's sole basis for ordering the cancellation of the reduced rail rate was its conclusion that the railroads had "unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage." [11]

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8. *Id.* at 78-79. For details as to the compensativeness of the reduced rail rate, see Report of Division 2 of the Commission, 323 I.C.C. at 760-762. Out-of-pocket costs, as computed by Rail Form A, include all of the expenses that can be assigned directly to a particular traffic movement plus 100 percent of the return on the depreciated value of equipment and 50 percent of the return on the depreciated value of road property. By contrast, fully-distributed costs include, in addition to the out-of-pocket costs, arbitrary assignments of constant expenses which, by their nature, "cannot be traced to particular units of output." See EXPLANATION OF RAIL COST FINDING PROCEDURES AND PRINCIPLES RELATING TO USE OF COSTS, I.C.C. COST SECTION STATEMENT No. 7-63 at 3, 4 (1963); Reduced Transcontinental Lumber Rates, 1961, 318 I.C.C. 815, 840-841 (1963). This Court has recognized that Rail Form A out-of-pocket costs cover the expenses of providing a particular service. See Chicago & N.W. Ry. Co. v. A.T. & S.F. Ry. Co., — U.S. —, 87 Sup. Ct. 1585, 1590 (1967).

9. 323 I.C.C. at 763-764, 326 I.C.C. at 81-82.

10. It should be noted that Division 2, which first considered the rate, found that it was lawful in all respects, saying:

> . . . we find for the encouragement of lawful competition and conclude that the proposed rate is just and reasonable, and, consistent with the [Supreme] Court's evaluation of section 15a(3) in the *New Haven case*, not destructively competitive. 323 I.C.C. at 765.

11. 326 I.C.C. at 85.

The railroads filed a complaint asking the lower court to enjoin and set aside the Commission's order on the grounds that it was without a rational basis and was not in conformity with law. Although the United States is a mandatory defendant in suits brought to set aside orders of the Commission, the Government did not undertake to defend but on the contrary filed an answer admitting that "the order of the Interstate Commerce Commission is invalid."

After receiving briefs and hearing oral argument, the lower court set aside the Commission's order "*first,* because it lacks a rational basis and thus is arbitrary and, *second,* because it is inconsistent with the objectives and purposes of Congress in enacting Section 15a(3) of the Interstate Commerce Act . . . and thus is not in accordance with law." [12]

Four jurisdictional statements have been filed by the several appellants. In each there is a request that this Court note probable jurisdiction.[13]

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12. 268 F. Supp. at 75-76.

13. Jur. St. in No. 797 at p. 14; Jur. St. in No. 804 at p. 18; Jur. St. in No. 808 at p. 9; Jur. St. in 809 at p. 17.

ARGUMENT IN SUPPORT OF THE MOTION

Involved in the proceedings before the Commission and in the lower court was the problem of how inherent advantage of lower costs is to be "recognize[d] and preserve[d]" as required by the National Transportation Policy and Section 15a(3) of the Interstate Commerce Act. This Court, in its opinion in *Interstate Commerce Commission v. New York, N.H. & H.R. Co.*, 372 U.S. 744, said the question "should be left for initial resolution to the Commission's informed judgment" (*Id.* at 761).

The appellee railroads do not here take the position that this is an unimportant question. To the contrary, it is of the utmost importance to them because their ability to grow and prosper in some measure commensurate with the economic growth of this nation depends upon its sound and intelligent solution. But they do say that the lower court's consideration was so thorough and its conclusions so obviously correct that plenary review by this Court is unnecessary and the granting of this Motion to Affirm would be appropriate.

Reduced to essentials, the several appellants' cases for plenary review are bottomed upon a claim that the lower court has laid down a rigid rule of law which deprives the Commission of its jurisdiction with respect to the recognition and preservation of the inherent advantage of lower costs.[14] This simply is not so.

The lower court plainly indicated that while normally Section 15a(3) requires the Commission not to interfere with reduced rates which are compensatory and beneficial to the proponent mode, deviation from this rule is per-

14. Jur. St. in No. 797 at p. 8; Jur. St. in No. 804 at pp. 13-14; Jur. St. in No. 808 at p. 6; Jur. St. in No. 809 at pp. 8-11.

mitted if the Commission articulates a rational basis for doing so.[15]

A review of the legislative history of Section 15a(3) the lower court says, demonstrates that Congress intended the Commission should normally recognize and preserve inherent cost advantage by adhering to the principles announced by it in *New Automobiles In Interstate Commerce*, 259 I.C.C. 475 (1945). If this is done, the objective of the Congress in enacting the Transportation Act of 1940 will be insured.[16]

As the lower court notes, in *New Automobiles*, the Commission in 1945 was concerned with the preservation of inherent advantages as required by the National Transportation Policy which had been brought into being by the Transportation Act of 1940. The Commission there concluded that the Policy in this respect would be served if reduced rates are required to be compensatory—that is, exceed out-of-pocket costs. In reaching this conclusion, the Commission rejected a demand of a competing mode that fully-distributed costs should be the floor for reduced rates. The lower court explains that the approach of the Commission in *New Automobiles* was consistent with the intent of Congress in enacting the Transportation Act of 1940, since, in the face of strong pressures, Congress itself had also rejected fully-distributed costs as the floor for reduced competitive rates.[17]

Because the stated objective of the Congress in 1958 for the new rule of intermode competitive ratemaking, incorporated in Section 15a(3), was to require the Commission in the future normally to adhere to the legal and economic principles of *New Automobiles*—from which it had deviated

15. 268 F. Supp. at 82.
16. *Id.* at 79-82.
17. *Id.* at 81-82.

in the years following their earlier pronouncement [18]—the lower court concluded that in the absence of strong justification to the contrary, *New Automobiles* should control contemporary reduced intermode pricing.[19]

The Commission's decision in *Ingot Molds* requiring the cancellation of a reduced railroad rate which is well above out-of-pocket costs and admittedly compensatory,[20] and which will make available profits to cover the railroads' constant costs not incurred in providing the ingot molds service, is plainly contrary to the principles of *New Automobiles*.[21] Thus, unless the Commission has set forth a strong justification for deviating from those principles, it must be concluded, as did the court below, that the *Ingot Molds* decision is contrary to law.

But as the lower court has explained in careful detail, the Commission's attempted justification for the deviation will not survive scrutiny.

The Commission in *Ingot Molds* says the existence of low-cost advantage, i.e., relative efficiency from a cost standpoint, should be determined by comparing the competing modes' fully-distributed costs. Its justification for this amounts to nothing more than a statement that it has done so in previous cases, and that not to do so here might be harmful to the protesting mode.[22] The self-apparent weakness of this conclusory justification is highlighted, as the court below explains, by the fact that nowhere in the earlier cases relied upon as precedents is there any explanation as to why fully-distributed cost comparisons should be used as the measure.[23] And in the one case referred to by the Commission where there was any re-

18. *Id.* at 79.
19. *Id.* at 80-82.
20. 326 I.C.C. at 78, 79, 82; 323 I.C.C. at 761, 763-764.
21. 268 F. Supp. at 82.
22. 326 I.C.C. at 82-84.
23. 268 F. Supp. at 76-78.

liance upon economic principles in selecting the cost level to measure inherent advantage of lower costs, fully-distributed costs were discarded and out-of-pocket costs used instead.[24] Further, as the lower court says, the failure of the Commission in *Ingot Molds* to provide adequate reasons for using fully-distributed costs as the measure of inherent advantage was "particularly wanting" because there was before it the unrebutted testimony of distinguished economists which strongly urged the use of out-of-pocket costs for this purpose.[25] While the Commission was not obli-

24. As the lower court notes, 268 F. Supp. at 77, the Commission in *Ingot Molds* referred to Grain in Multiple Car Shipments—River Crossings to South, 321 I.C.C. 582 (1963), as support for the use of fully-distributed costs to determine the existence of low-cost advantage, but in that case, after an extensive analysis, the Commission, adopted the use of out-of-pocket costs for such purpose. One of the Commission's bases for using out-of-pocket costs was that the competing mode was unregulated, 321 I.C.C. at 596-604. Significance should not be lost of the fact that unregulated transportation operates lawfully and constitutes a major segment of the national transportation system. But nowhere in *Ingot Molds* does the Commission explain why the out-of-pocket standard used in *Grain in Multiple Car Shipments* should not be equally applicable to competition between regulated modes. See 326 I.C.C. at 81.

25. 268 F. Supp. at 77. The railroads presented four economists whose testimony dealt exclusively with the recognition and preservation of inherent advantage of low cost. Their testimony is printed in the Appendix to Railroads' Brief in the lower court at App. 35-135. As to the use of out-of-pocket costs, *i.e.*, incremental costs, to measure relative efficiency from the cost standpoint, Dr. Heflebower, for example said:

> Where the intermediate long-run incremental cost of another transport industry is above that of railroads (for service of equivalent quality) that other industry is not as economically efficient as the railroads. On the other hand, where the intermediate long-run incremental cost of any other transport mode is below that of railroads, it is more efficient, *Id.* at App. 99.

If the Commission had adhered to sound economic principles and had used out-of-pocket costs to measure inherent advantage of lower costs, it should have concluded such advantage was possessed by the railroads since it found that the railroads' "out-of-pocket costs are lower than the barge-motor lines' variable costs." 326 I.C.C. at 84.

gated to accept or to agree with this testimony, as the lower court said: "such did at least, . . . make it necessary for the Commission to set forth adequate reasons to support its own approach. Such reasons are lacking in the Commission's report." [26]

The lack of a stated rationale for using a comparison of fully-distributed costs for determining the existence of low-cost advantage is plain enough from the Commission's report and is made even more so by the lower court's opinion. But if this is so with respect to the determination of low-cost advantage, the lack of rationale becomes more

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26. 268 F. Supp. at 77. See also Chicago Junction Case, 264 U.S. 258, 265; Schaffer Transp. Co. v. United States, 355 U.S. 83, 91-92.

The Commission in its Jurisdictional Statement (No. 809 at pp. 14-16) contends that the railroads failed to carry the burden of showing "that their proposed measure of the inherent advantage of low cost [*i.e.*, the use of out-of-pocket costs] better tested the relative efficiency of competing modes than the established standard [*i.e.*, the unsupported use of fully-distributed costs by the Commission in earlier cases]." It was the railroads' position, as set forth by Dr. Heflebower (*supra*, n.25), that the best measure of low-cost advantage, or of relative efficiency from the cost standpoint, is a comparison of the two competing modes' out-of-pocket costs. Dr. Heflebower was supported by testimony offered by Dr. Baumol in the form of a pronouncement by nine leading economists that:

> An offshoot of the fully distributed cost fallacy is the contention that rail rates should not be permitted to go below the "full cost of the low-cost carrier" (such carrier being determined on the basis of comparative fully distributed cost), whether it be that of a railroad or a different mode of transport. This contention, also, has no validity as a measure of "inherent advantage" or relative economy in the utilization of economic resources of the nation. For the reasons pointed out above, the low-cost carrier is properly identified by incremental cost, not by so-called "full" cost. (Appendix to Railroads' Brief in lower court at App. 70).

Nowhere in the record is this position of the railroads rebutted. If, therefore, the railroads had the burden of proof on the question of how inherent advantage of lower costs is to be measured, they more than bore it.

startling when the Commission addresses itself to the infinitely more crucial problem of how such advantage, with whatever mode it exists, should be preserved.[27] Certainly, this is a problem of paramount importance—but the Commission disposes of it in three sentences, none of which provides any reason for the solution selected. This is all the Commission says:

> In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation.[28]

The court below quite rightly questions the logic of the Commission's conclusion in the circumstances present and points out that it is wholly unsupported by the cases referred to.[29] The lower court could well have added that

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27. Division 2 of the Commission recognized that the mere determination of which mode has the inherent advantage of lower costs is at most a first step and that the heart of the problem is concerned with how such advantage should be preserved. 323 I.C.C. at 763-765.

28. 326 I.C.C. at 85.

29. As the lower court indicates, 268 F. Supp. at 79, it is utterly beyond comprehension how this particular rail rate "would deprive shippers of cheaper water transportation" since the shipper still has available the existing water-truck service at the same charge that was in effect prior to the rail reduction. In addition to such water-truck service, the shipper also has the availability of rail service at the same charge. Far from being deprived of cheaper water service, the shipper now has a choice of two services, both offered at the identical charge.

Further it should be noted that the cases of this Court, referred to by the Commission as support for its method of preserving inherent advantage of lower costs, not only were inapposite because they were not concerned with Section 15a(3) or the preservation of inherent

it is equally evident the Commission has established as the floor for one mode's reduced pricing a different mode's fully-distributed cost level without any explanation whatsoever as to how this artificial price-pegging device preserves inherent advantage of lower costs or otherwise fosters any of the purposes of the National Transportation Policy—for example, the "establishment and maintenance of reasonable charges for transportation services."

This Court, in *New Haven,* left, for initial resolution by the Commission, the important questions of how the inherent advantages of competing transportation modes should be recognized and preserved when judging the reasonableness and lawfulness of reduced intermode competitive pricing. Here the Commission, in a proceeding unencumbered by any real dispute as to the facts, had these questions squarely before it. To assist the Commission in its consideration of these questions, the railroads presented the testimony of four eminent economists. The substance of the unrebutted testimony of these economists was that the use of fully-distributed costs as a floor for reduced intermode competitive pricing cannot be justified and that the advantage of lower costs is best recognized and preserved by establishing the proponent mode's own out-of-pocket costs as the floor. This, they said, is the basic and elementary teaching of well-recognized economic principles that are universally applicable to all types of business and industrial enterprises and equally applicable to the transportation industry. They further explained that the use of the out-of-pocket cost floor would implement and add prac-

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advantage, but also lacked value as precedents in this area because this Court in *New Haven* made no reference to them at all, saying that the question of how inherent advantage is to be preserved was for the Commission initially to resolve. Interstate Commerce Commission v. New York, N.H. & H.R. Co., 372 U.S. 744, 761.

tical meaning to the mandates of the National Transportation Policy.[30]

Surely, in view of the importance that this Court has placed upon the problems and the depth of the railroads' efforts in advancing a sensible, workable and legally sound solution, the Commission's incredibly perfunctionary solution to the critical phase of the problems, namely, the preservation of inherent advantage, falls far short of reasonable expectations. And more significant perhaps from the standpoint of the question now before this Court, it emphasizes the soundness of the lower court's judgment that the Commission's unsupported conclusion regarding the preservation of low-cost advantage lacks a rational basis.

The lower court has not assumed to itself, as claimed in the several Jurisdictional Statements, any jurisdiction exclusively that of the Commission. Rather, it has exercised the entirely proper function of a court reviewing administrative agency action, and has made a careful and diligent study to determine how the relevant statutory provision should be interpreted to carry out the objectives and purposes of the Congress. See *Fed. Trade Comm. v. Gratz*, 253 U.S. 421, 427; 4 DAVIS, ADMINISTRATIVE LAW TREATISE, § 30.09, at p. 241 (1958). Based upon this study, the lower court has concluded that the inherent advantage of lower

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30. The testimony of the economists is printed in the Appendix to the Railroads' Brief in the court below at App. 35-135. Their views are fully consistent with the pronouncements of the Council of Economic Advisers in their 1965 ANNUAL REPORT (at p. 127) and of the Royal Commission on Canadian Economic Prospects (Nov. 1957) which said:

> Of course, any traffic which meets its long-run out-of-pocket costs and makes some contribution to common overheads, no matter how small, should be carried by the carrier concerned; in this way overheads on the remaining traffic are reduced, all shippers are better off, and the most efficient use of transport resources is promoted.

costs will be preserved as required by the National Transportation Policy by the Commission adhering to the policy of normally approving constructive rate reductions which are compensatory and "not detrimental" to the proponent mode's own "revenue requirements."[31]

But the lower court made it plain that it was not establishing the normal rule as an absolute one and that deviations might be possible if supported by a rational basis, saying:

> We do not mean to suggest that there may not be situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory. What we do suggest is that Congress has expressed a clear intent that reduced compensatory rates should normally be allowed and that the record here and the Commission's report supply no basis for disregarding that intent.[32]

In this instance, since a rational basis for an obvious deviation is wholly lacking, the lower court correctly concluded that the Commission's condemnation of the reduced rail rate is "not in accordance with law."

THE RELIEF REQUESTED

It is most respectfully submitted that a case for plenary review does not here exist and therefore the judgment of

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31. Interstate Commerce Commission v. New York, N.H. & H.R. Co., 372 U.S. 744, 759.

32. 263 F. Supp. at 82-83.

the lower court should be affirmed by the granting of this motion.

Respectfully submitted,

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PROOF OF SERVICE

I, CARL HELMETAG, JR., one of the attorneys for the the Railroad appellees herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the —— day of December, 1967, I served copies of the Motion to Affirm of the appellee Railroads on counsel for all the parties to this action as follows:

1. On the United States, by mailing copies in duly addressed envelopes:

A. With first-class postage prepaid to the Honorable Edwin N. Griswold, Solicitor General, Honorable Ramsey Clark, Attorney General, Honorable Donald F. Turner, Assistant Attorney General, Lionel Kestenbaum, Esq., and Robert K. Johnson, Esq., Attorneys, Department of Justice, Washington, D. C. 20530.

B. With air mail postage prepaid to the Honorable Ernest W. Rivers, United States Attorney and Honorable William B. Martin, Assistant United States Attorney, Federal Building, Room 211, Louisville, Ky. 40201.

2. On the appellant Interstate Commerce Commission, by mailing copies in duly addressed envelopes, with first-class postage prepaid to its attorneys, Honorable Robert W. Ginnane, General Counsel, Honorable Fritz R. Kahn, Associate General Counsel, Honorable Leonard S. Goodman, Associate General Counsel, Washington, D. C. 20423.

3. On the separate appellants herein, by mailing copies in duly addressed envelopes:

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CARL HELMETAG, JR.

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In the

SUPREME COURT OF THE UNITED STATES

October Term, 1967

No. 797

AMERICAN COMMERCIAL LINES, INC., *ET AL.*,
Appellants,

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY
and
THE PENNSYLVANIA RAILROAD COMPANY, *ET AL.*,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR APPELLANTS

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In the

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Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR APPELLANTS

OPINIONS BELOW

The opinion of the three-judge District Court for the Western District of Kentucky in No. 5227, *Louisville and Nashville Railroad Company and The Pennsylvania Railroad Company v. United States and I.C.C.* (App. 12) is reported at 268 F. Supp. 71 (1967).

The initial report of the Interstate Commerce Commission, Division 2, in Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.* (App. 35), is re-

ported at 323 I.C.C. 758 (1965). The final report and order of the Commission on reconsideration (App. 60) is reported at 326 I.C.C. 77 (1965).

JURISDICTION

This action was brought by appellees in a three-judge federal district court under 28 U.S.C. 1336, 2321-2325, to enjoin, annul and set aside an order of the Interstate Commerce Commission in *Ingot Molds, Pa. to Steelton, supra.*

The judgment of the United States District Court for the Western District of Kentucky setting aside the order of the Commission and remanding the matter for reconsideration was entered on May 15, 1967. (App. 32) Notice of appeal was filed with the district court on July 13, 1967). (App. 11)

The jurisdiction of this Court under 28 U.S.C. 1253 and 2101(b) to review the judgment of the district court on direct appeal was invoked and, by order entered January 15, 1968, this Court noted probable jurisdiction.

STATUTES INVOLVED

The National Transportation Policy (49 U.S.C. preceding Sections 1, 301, 901 and 1001) and Section 15a(3) of the Interstate Commerce Act (49 U.S.C. 15a(3)) both of which are reproduced in the Joint Appendix to Briefs (App. 34).

QUESTIONS PRESENTED

This appeal presents issues which far transcend in importance the particular railroad rate or the competition for the ingot molds traffic which is directly involved. The ultimate question, in what has undeniably become a "test case" in the railroads' legislative-judicial campaign of recent years to substantially increase their share of the total transportation market, is the lawfulness of selectively reduced rail rates,

below the railroads' full costs, established with the aim of diverting traffic from lower-cost water carriers. This fundamental and, from the standpoint of both the barge lines and the public, critical question, arises within the framework of a drastic reduction in the particular point-to-point rail rate upon a commodity, ingot molds, which is itself of minor traffic significance.. This rate has apparently been chosen, however, by the proponent railroads as the vehicle for seeking to assert their so-called "incremental" or out-of-pocket cost theory of competitive rate-making.

More strictly speaking, the questions presented by this appeal arise from the opinion and judgment of the District Court which set aside and permanently enjoined the order of the Interstate Commerce Commission in *Ingot Molds, Pa. to Steelton, Ky.*, 323 I.C.C. 758, 326 I.C.C. 77 (App. 35, 60), and remanded the matter to the Commission for appropriate action. As previously recited in the Jurisdictional Statement of these appellants, the questions are:

1. Did the District Court err in holding that the Commission failed to state a rational basis and make adequate findings to support its conclusion that full costs of two competing modes must be compared to determine which mode has the inherent cost advantage within the meaning of the National Transportation Policy?

2. Did the District Court err in holding "that the Commission has failed to state a rational basis to support its selection of the 'fully distributed' costs of the barge-truck mode as the floor for reduced railroad rates"?

3. Did the District Court err in holding that the Commission's use of full cost to determine which mode possessed the inherent advantage is contrary to *Interstate Commerce Commission v. New York, N. H. & H. R.R. Co.*, 372 U.S. 744, 760-761 (1963).

4. Did the District Court err in holding that the Commission misinterpreted and misapplied the Transportation Acts of 1940 and 1958 in comparing the full costs of competing modes of transportation to measure inherent advantage?

5. Did the District Court err in holding that the Congress intended to restrict the power of the Commission, without discretion, to determine the lawfulness of the competitive rates under Section 15a(3) of the Interstate Commerce Act to consideration of a single test – whether such rates are above out-of-pocket costs.

STATEMENT OF THE CASE

Description of Appellants

Appellants, American Commercial Lines, Inc., Mississippi Valley Barge Line Company, Ohio River Company, and Union Barge Line Corporation are certificated common carriers authorized by the Interstate Commerce Commission to conduct water carrier service between ports and points on the Mississippi River system. Waterways Freight Bureau is a voluntary non-profit organization, composed of common carriers by water engaged in the transportation of freight by barge. The principal functions of the Bureau relate to rate-making procedures.

Background of the Proceeding

To state that the present controversy began in the late months of 1963 with the publication by the two principal railroad appellees of a reduced rate on ingot molds between the involved points is like reporting that the United States began with the ratification of the Constitution. Such recitals, while technically accurate, are highly insensitive to an appreciation of the degree to which the "past" is, indeed, "prologue" to the present and future. In this instance, the

pre-1958 decisions of the Commission in intermodal rate cases, the legislative history of Section 15a(3) of the Interstate Commerce Act enacted in that year, and the recent consideration by this Court of the history and purpose of that provision, like the underside of the iceberg, are all an integral, even if unseen, part of this railroad "test case."

In the era before the enactment of Section 15a(3) in the Transportation Act of 1958, marked as it was by the gradual development of carrier cost-finding skills, the Commission, admittedly vacillating in its approach, struck down a number of railroad rate proposals on the ground of prospective traffic diversion from competing water carriers. In thus seeking to allocate a "fair share" of the traffic to the water carriers so as to keep them operational and financially afloat, the Commission, more often than not, made no determination of relative advantage as between the modes of transportation, although earlier it had employed this standard. The typical result of the attempted allocation of traffic was the prescription of a differential in the rates of the water carriers under those maintained by the rails.

The railroads clamored for, and were eventually accorded, remedial legislation against Commission "protectionism" but, most significantly, as will be seen hereinafter, in intermodal contests it was not the sweeping elimination of regulatory restraint that they had sought. Nevertheless, it must be conceded that the legislation which ultimately materialized as Section 15a(3) deprived the Commission of its erstwhile role of "giant handicapper" and compelled the consistent application of an earlier, admittedly oft-disregarded, standard in intermodal rate controversies. It is the nature of that standard – as to which it is here urged that the District Court has seriously erred – which constitutes a primary issue in this proceeding.

This Court has previously been called upon to provide guidelines to the Commission in this endeavor to resolve disputed intermodal rate actions in *Interstate Commerce Commission v. New York, N. H. & H. R.R. Co.*, 372 U.S.

744, decided in 1963. In the *New Haven* case, which was actually disposed of upon other grounds because the cost comparisons essential to a determination of inherent advantage under the National Transportation Policy were there lacking, this Court, after a comprehensive review of the legislative history of Section 15a(3), "spelled out" the functions and responsibilities of the Commission in just such a situation as was almost immediately thereafter presented in the *Ingot Molds* case. It was with the statutory construction and guidelines of *New Haven* freshly in mind that the Commission approached the issues presented by the ensuing publication by the Pennsylvania and Louisville & Nashville railroads of the reduced rate on ingot molds between the Pittsburgh area and Steelton, Ky. That rate, corresponding exactly (and not coincidentally) to the barge-truck level, was filed by those railroads shortly after the *New Haven* decision with the obvious purpose of seeking a resolution of the issues which the railroads believed had not been there completely settled because of the deficiencies of the record in that case.

Proceedings Before the Commission

The instant controversy commenced with the publication by the Pennsylvania and L&N, in schedules then proposed to be made effective December 1, 1963, of a reduced rate on ingot molds and ingot mold stools from Neville Island and Pittsburgh, Pa. to Steelton, Ky. of $5.11 per gross ton, minimum weight 600 tons in a single shipment and 125,000 pounds per car, moving in 12 or less cars at one time. The then applicable rail rate on these commodities between the same points, converted to gross tons, was $11.86, subject to a carload minimum weight of 100,000 pounds, but, very little of the involved traffic moved at that substantially higher rate.

The total charge for movement in the competing barge-truck service was the same as the later matching rail rate, $5.11 per ton, consisting of a barge rate of $3.32, minimum 600 gross tons, a transfer charge of 95 cents at Owensboro,

Ky. and a truck charge of 84 cents for the 3.5 miles from the river terminal to destination. It is abundantly clear that the substantially reduced rail rate, together with its accompanying minimum weight requirements, was fixed *without reference to railroad costs or any other railroad service considerations* at the precise level of the barge-truck service with a view to diverting the ingot molds traffic from the water onto the rails. The District Court has now held, in effect, however, that this railroad rate, made expressly to achieve rate equality with the competition, is to be judged as to lawfulness without regard to the demonstrated superiority of that competition so long as it covers the rails' out-of pocket costs.

Upon protest by appellant, Waterways Freight Bureau, the proposed rail rate was suspended and placed under investigation by the Commission. The statutory period of suspension was voluntarily extended by the railroads until after Division 2 of the Commission had found the rate to be lawful. (App. 35) Thereafter, the railroads made the rate effective on March 19, 1965 and it continues to apply at the present time, notwithstanding the fact that the entire Commission, in its report and order of November 9, 1965, here in issue, subsequently found the rate to be unlawful and ordered it canceled. (App. 60) The facts are clearly stated in the several reports of the Commission and appear to be undisputed by the parties. As previously indicated, from the time that the plant of the receiver at Steelton was completed in 1953 until the reduced rail rate, which is the subject of the controversy, became effective in 1965, the preponderance of the ingot molds traffic moved via the barge-truck route. The report of Division 2 recites that the barge lines handled 4,320 tons in 1962, 5,017 tons in 1963 and 1,500 tons during the first three months of 1964 whereas the railroad traffic for the corresponding periods was 112, 276 and 116 tons, respectively. (App. 37-38) Although similar traffic comparisons for the period *after* the reduced rail rate became effective are not of record, the Commission found, without contradiction, that "rail respondents virtually

conceded that all of the traffic would move by rail." (App. 64) The ensuing diversion of the preponderance of the ingot molds traffic from the barge-motor route has not been disputed.

The report of Division 2, finding the rail rate to be lawful, was served on February 17, 1965. (App. 35) It determined, upon the basis of cost evidence presented by the parties, that the railroads' costs of providing the involved service under the then proposed $5.11 rate were $4.689 per ton, out-of-pocket, and $7.594 on a fully-distributed basis, and concluded, therefore, "that the proposed rate exceeds the respondents' out-of-pocket costs, but is below their fully distributed costs." (App. 39) It was further found that full costs via the barge-truck route computed at $5.1959 afforded a valid comparison with rail fully-distributed costs. (App. 39).

Turning to the threshold issue, Division 2 ruled, just as did the entire Commission thereafter, that the foregoing rail and water-motor fully-distributed costs constitute the appropriate standard for comparing the inherent advantages of low cost in this intermodal rate dispute. It went on, however, to hold that the barge lines had, in effect, waived their right to protection against the equalizing rail reduction by voluntarily maintaining a rate producing total charges ($5.11) below the barge-truck full costs ($5.19) developed in this proceeding.

Reconsideration of the report of Division 2 was sought by both the rail carrier respondents and the barge line protestants, the former to eliminate the standard of fully distributed cost as the measure of the low cost mode and the latter to reverse the Division's finding that the barge line had waived the right to protection of its inherent cost advantage. Upon reconsideration, the entire Commission, by its report of November 9, 1965 (App. 60), sustained the finding by Division 2 that fully distributed costs should constitute the measure of inherent cost advantage within the meaning of the National Transportation Policy. The Commission likewise agreed with the Division that, by this

standard, the inherent advantage of lower cost lies with the barge-truck route. The Commission reversed the Division's report with respect to the alleged waiver, holding that an inherent cost advantage either exists or does not exist and is not to be lost by, as here, the inadvertent establishment of a rate below a carrier's fully distributed cost level. (App. 68-69) Accordingly, the Commission required that the reduced equalizing rate of the railroads be canceled on the ground that "by reducing its rate below the level of the barge-truck full costs, respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage." (App. 71) In view of its findings, the Commission denied the railroads' petition for reconsideration.

Proceedings Before the District Court

Appellees, Pennsylvania and L&N, the two railroad respondents before the Commission, directed to cancel the reduced rate here in issue, filed suit in the U. S. District Court, Western District of Kentucky, to set aside the Commission's order on the grounds, generally, that it was based upon an unlawful and erroneous interpretation of the governing statutes and lacking in a stated rational basis. Attesting to the importance of the issues here involved, forty-eight additional railroads – virtually all of the major railroads in the United States – intervened as plaintiffs below in this proceeding. The barge lines, appellants here, together with the American Trucking Associations, Inc., the National Motor Freight Traffic Association, Inc., the National Tank Truck Carriers, Inc., the American Waterways Operators, Inc., appellants in the related appeals in Nos. 804 and 808, were permitted by the District Court to intervene in support of the Commission's order. The Department of Justice, for the United States, confessed error and participated before the District Court as an additional plaintiff.

The opinion and judgment of the three-judge District Court, invalidating the Commission's order upon the two

stated grounds of lack of a rational basis and inconsistency with the objectives and purposes of Congress in enacting Section 15a(3), were entered on May 15, 1967. (App. 12, 32) Notice of appeal was filed by these appellants with the District Court on July 13, 1967. Appeals were taken and jurisdictional statements filed jointly on behalf of these appellants and also on behalf of American Trucking Associations, Inc., et al., the American Waterways Operators, Inc., and the Interstate Commerce Commission. (Nos. 797, 804, 808 and 809) A Motion to Affirm was filed on behalf of appellee railroads and, most significantly, the Solicitor General filed a Memorandum For The United States which recites, in pertinent part, as follows:

> "The appeals present a major issue reserved by this Court in *Interstate Commerce Commission v. New York, New Haven & Hartford R.R. Co.*, 372 U.S. 744, 760-761 – Whether out-of-pocket costs, fully distributed costs, or 'some different measure' should be the criterion for determining which mode of transportation has the inherent advantage under Section 15a(3) and the National Transportation Policy. The obvious importance of the question to the future regulation of the Interstate Commerce Act and the National Transportation Policy suggests the appropriateness of plenary consideration. We therefore urge this Court to note probable jurisdiction." (Footnote omitted.)

By order entered January 15, 1967, this Court noted probable jurisdiction.

ARGUMENT

I.

Summary of Argument

There is here squarely presented for plenary judicial review the question of the *power* of the Interstate Commerce Commission under Section 15a(3) of that Act to carry out the mandate of the National Transportation Policy, expressly incorporated in that section, to, first, "recognize" and, thereafter, take appropriate action to "preserve" the "inher-

ent advantages" of each mode of transportation. This provision of the Act, added by the Transportation Act of 1958, was only recently – and it had been thought, definitively– construed by this Court, after exhaustive research into its legislative history, in *Interstate Commerce Commission v. New York, N. H. & H. R.R. Co., supra.*

In *New Haven* this Court expressly "left for initial resolution to the Commission's informed judgment" the task of determining how the required measurement or protection of inherent advantage should be accomplished in intermodal rate disputes like *Ingot Molds*. (372 U.S. at 370) Most significantly, nowhere did that opinion even imply that the Commission must keep "hands off" any proposed rate found to be compensatory,[1] with no power to either measure or protect demonstrated inherent advantage in such situations. That, however, is the holding of the District Court, in any event in what is there characterized as the "normal" situation.

In *Ingot Molds*, obviously chosen by the railroads to both test and "round out" the principles laid down in *New Haven*, the Commission expressly undertook to implement the guidelines provided for it in that case. As it happens the situation presented by the facts in *Ingot Molds* of a below-full-cost rail rate impinging upon a lower cost mode is precisely that which moved the Congress in enacting Section 15(a)(3) to reaffirm the power of the Commission to protect the inherent advantage of the lower cost mode. (372 U.S. at 758-59)

Despite the fact that the findings in *Ingot Molds* are on "all fours" with the "precise example given to the Senate Committee, which led to the language adopted", as this Court noted in pointing to the "power" of the Commission to prevent railroad impairment of the inherent advantages of other

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[1] The term "compensatory" is used herein to mean, as in the opinion below, any rate in excess of the relevant out-of-pocket cost of performing the service.

modes (372 U.S. at 758), the District Court, relying upon the same precedents, has come to a contrary conclusion as to the Commission's jurisdiction. The court below erroneously finds that the Commission's order is invalid for failure "to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs." This holding, applied to the intermodal rate controversies which were the subject of Section 15a(3), would, by a sweeping – and ill-defined – judicial construction, legislate a restriction upon the Commission's powers that, for all practical purposes, restricts its function to mere railroad cost-finding.

The decision of the court below would render the Commission *powerless*, except in some abnormal situations left entirely undefined, to prohibit a reduced rate which is in excess of the proponent carrier's out-of-pocket or "incremental" costs, irrespective of which mode of transportation may be affirmatively found to possess the inherent advantage of lower cost, and without regard to the public interest in preserving such economic transportation service. Contrary to the holding by this Court in *New Haven* that the "initial resolution" of "how either carrier's inherent advantages should be measured or protected" is for the Commission, the opinion below deprives the Commission of even the right of that initial resolution. The lower court declares it beyond the power of that agency to either measure or protect where the proposed rate exceeds out-of-pocket costs. The fact that the lower court has held open the possibility that there may be "situations where the Commission has power" (App. 31-32) to prohibit reduced rates even though compensatory fails either to cure the error of statutory interpretation or to assure the preservation in the public interest of adequate transportation by all modes.

Ingot Molds is the typical situation contemplated by Congress in rejecting "the three shall nots" legislation sought by the railroads, and, in lieu thereof, imposing the restraints

of the National Transportation Policy upon the competitive freedom otherwise accorded by Section 15a(3). As this Court recognized in *New Haven* "the three shall nots", which it is conceded would have precluded any comparison of the proposed rail rate with those maintained by other modes, were "explicitly rejected" in committee. (372 U.S. at 754) Nowhere does the opinion of the District Court undertake to reconcile this Congressional rejection with its divergent views as to the Congressional intent. Certainly, had Congress intended to make compensativeness virtually akin to lawfulness, as the opinion below suggests, it would not have rejected "the three shall nots" and equivalent proposals in favor of the National Transportation Policy objectives in fact incorporated into Section 15a(3).

The change in the standards to be applied by the Commission in intermodal cases actually effected by Section 15a (3) was to require a showing of inherent advantage as a prerequisite to protection from destructive rate-making by another mode. The *New Automobiles* case (*New Automobiles in Interstate Commerce*, 259 I.C.C. 475 (1945)), upon which the District Court relies, stands only for the proposition that rates should not be disapproved *merely* because of their impact upon another mode, nothing more. In requiring that, henceforth, entitlement to protection be based upon a showing of inherent advantage, Congress did, indeed, legislate the *New Automobiles* principle, as suggested by the District Court, but, clearly, Commission action based upon *demonstrated* lower cost is not at odds with that principle. It is, thus, submitted that the statutory basis for the Commission's order herein is indisputably established by the legislative history of Section 15a(3) and the recent opinion of this Court in *New Haven*.

The question of the power of the Commission is, of course, different from the first ground for decision stated by the District Court, the asserted failure of the Commission to state a rational basis to support its selection of the fully-distributed cost comparison as the measure of intermodal

inherent advantage. Full cost is a standard that has frequently been employed by the Commission as well as by other agencies. It was urged as the appropriate measure in the *New Haven* case by the United States and expressly referred to by this Court as one of the methods which might be utilized by the Commission in its "initial resolution" of the problem of recognizing and preserving inherent advantage in a rail-water contest. In an effort to impugn the concept of fully-distributed costs the railroads presented extensive testimony by four economists in support of their contention that rates should be tested by out-of-pocket or so-called "incremental" costs. The Commission gave full consideration to this testimony and rejected these partial costs *for the purpose of measuring the inherent advantage of lower cost in intermodal controversies*. The Commission's report expressly incorporated the prior findings of Division 2 on this subject, which after discussing the railroads' incremental cost testimony, found that:

> "For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the Nation's transportation system is to be healthy." (App. 40)

"The use of out-of-pocket or incremental costs" was expressly rejected as the measure of inherent advantage on the ground that this theory "ignores" the recognized "existence of constant costs". The principle that the cost advantages which are *inherent* in a particular form of carriage cannot validly be compared unless all costs of the enterprise are included in the equation, is so axiomatic that it should require little further elaboration.

The entire Commission, in turn, in its report, quoted from the Division's conclusion adhering to the full cost standard and stated "We agree." The basis for this conclusion is to be found in the Commission's prior reference to its conclusions in *Grain in Multiple-Car Shipments—River Crossings to So.*, 325 I.C.C. 752, 772 (1963). In the language there quoted from the *Grain* case, the Commission

had reaffirmed the use of full costs as the standard of inherent advantage in intermodal controversies.

Applying the full cost standard to the rates before it, the report went on to find, just as in the example used by this Court in *New Haven*, that the railroads' rate, below the full costs of the barge-truck mode, "unlawfully impinged" upon the latter's ability "to assert its inherent cost advantage" and would, if unchecked, "deprive shippers of cheaper water transportation." (App. 71) Certainly, this is the Commission's function under the National Transportation Policy. Moreover, in taking action, clearly the Commission followed the guidelines laid down by this Court in *New Haven*, most particularly in Footnotes 12 and 14. (372 U.S. at 760-61) The court below seems to have been persuaded by the argument of the appellees here that the Commission's reasoning should have been set forth in greater detail, but, assuredly, so long as the rationale is clearly expressed, the findings of an administrative agency need not be rendered *in extenso*.

Questions as to the interpretation of the opinion below, that is, whether it laid down a rigid rule of statutory interpretation or if not, the nature of the "situations" in which the Commission is empowered to act, need not here be resolved. The basic question of the lawfulness of the Commission's order here in issue is one which this Court can approach directly and independently, aided by its prior research of the same issues in *New Haven*. Judged in this manner, and measured against established principles of administrative law, the administrative expertise reflected in the "initial resolution" by the Commission in this proceeding should properly be sustained.

There can be no doubt that, in *Ingot Molds*, the railroads are seeking a license for a wholesale assault, through selective "incremental" rate-making, upon the traffic of competing modes of transportation. Admittedly, Congress intended that rail carriers should have greater freedom in pricing, but, at the same time, deemed it expedient to limit their manifest power to destroy other modes where the latter establish

their inherent advantage, most notably as in the utilization of a great natural resource such as the nation's waterways. The District Court has failed to appreciate that this is the very intermodal departure from the "normal" right of compensatory pricing with which Congress intended that the Commission be empowered to deal.

Congress has already defined the "situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory" to which the opinion below referred. (App. 31) It is the situation that occurs, just as in *Ingot Molds*, when another mode claims *and proves* that it has the lower costs and that a competitor's otherwise "normal" compensatory rate would impair that inherent advantage. In such a situation the public interest in maximizing the use of natural resources and in preserving an adequate transportation system by all modes demands that the Commission do just what it did here – strike down the offending rate of the higher cost, more predatory, mode. The District Court has articulated no sound basis in law or fact for upsetting the Commission's discharge of its responsibilities under the National Transportation Policy by here taking such action.

II.

The District Court's Invalidation of the Commission's Order Rests upon a Misinterpretation of Section 15a(3) and of This Court's Opinion in *New Haven*

A. The Significance of the Statutory Issue Cannot Be Over Emphasized.

The three-judge District Court states two grounds for its conclusion to set aside the order of the Commission in the *Ingot Molds* case, "*first*, because it lacks a rational basis and thus is arbitrary and, *second*, because it is inconsistent with the objectives and purposes of Congress in enacting Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. sec. 15a

(3) (App. 34), and thus is not in accordance with law." (App. 17) The first stated ground is, hence, more one of articulation than principle, and presents the conventional issues invariably raised upon judicial review of agency decisions. It will be demonstrated hereinafter that the Commission's report is not defective as lacking a rational basis, however, the fundamental overriding importance of the second stated ground of decision requires that the issue of the Commission's powers under Section 15a(3) be given primary consideration upon this appeal. Upon the resolution of this issue depends not only the future course of the regulation of intermodal competition, as the Memorandum For The United States points out (p. 4), but, also, it is submitted, from the standpoint of the barge lines in any event, the very existence of effective competitive transportation service.

In their Jurisdictional Statement, these appellants, seeking to stress the importance of reconstituting the Commission's powers under Section 15a(3), characterized this appeal as a "sequel" to the *New Haven* case. (J.S. p. 7) To the same effect the opinion below, after quoting from *New Haven* this Court's recital of the questions said there to be left to the Commission for "initial resolution" stated:

> "This is the first case following *New Haven* in which a court has been called upon to review a determination by the Commission of how the inherent advantage of competing modes of transportation should be recognized or preserved." (App. 18)

The appellee railroads, in their Motion to Affirm herein, likewise observe that the Commission here had "squarely before it" the "important questions" left in *New Haven* " how the inherent advantages of competing transporta modes should be recognized and preserved when judging the reasonableness and lawfulness of reduced intermode competitive pricing." (Motion, p. 11) The Solicitor General in the Memorandum For The United States noted that the appeals herein present a major issue reserved by this Court in *New Haven*. i.e.,

> "whether out-of-pocket costs, fully distributed costs, or 'some different measure' should be the criterion for determining which mode of transportation has the inherent advantage under Section 15a(3) and the National Transportation Policy." (p. 3-4)

Clearly, therefore, there is general agreement that the opinion of this Court in *New Haven* represents the point of departure in this case. The Commission likewise recognized the significance of *New Haven* and undertook the tasks left to it for "initial resolution" in the light of the comprehensive guidelines there provided by this Court. The opinion below would preclude the completion of these statutory duties.

The District Court, misconstruing *New Haven* and the legislative history of Section 15a(3) there clearly enunciated, has, by judicial interpretation, injected a rigidity of regulatory policy not intended by Congress and entirely alien to the flexibility of administrative process. In so doing it will make possible destruction of the very inherent advantage of water transportation that Section 15a(3) undertook to preserve. Passing for the moment the question of the clarity of the exposition of its selection of fully-distributed costs as the measure of inherent advantage, the Commission did undertake *to resolve* the issue expressly reserved in *New Haven*; the District Court, on the other hand, erroneously holds *as a matter of law* that out-of-pocket costs are ultimate criterion of a lawful rate and, hence, that "normally" there is no such issue to be resolved. In this, the opinion below clearly misconstrues the statute as spelled out by this Court in *New Haven*. Obviously, if this were the rule of law then this Court in *New Haven*, in the very example there employed, actually left nothing for the Commission to decide. It seems apparent that the District Court failed completely to understand the statement by this Court (372 U.S. 758) that

> "The principal reason for this reference, (to the policy) as the hearings show, was to emphasize the power of the Commission to prevent the railroads

> from destroying or impairing the inherent advantages of other modes. And the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads by establishing on a part of their operations a compensatory rate below their fully distributed cost, forced a smaller competing lower cost mode to go below its own fully distributed cost and thus perhaps to go out of business." (First emphasis is by the Court.)

It seems equally apparent that the strained construction advanced by the District Court stems in large measure from its failure to appreciate the true nature of the regulatory change accomplished by Section 15a(3).

B. The Change Wrought by Section 15a(3) Was from Mere Need for Intermodal Protection to Entitlement Based upon *Demonstrated* Inherent Advantage.

The historic and legislative background of Section 15a(3) not only clarifies the change in intermodal regulation that it in fact accomplished, but also makes abundantly clear *what it did not do*. The history of that section does not compel the conclusion that the Commission must sanction all compensatory rates, as suggested by the District Court. This Court has fully and fairly recited that background in *New Haven*, but it is deserving of repetition since it points up wherein the District Court went astray in the opinion below.

At the outset, appellants hasten to acknowledge that Congress, in promulgating Section 15a(3), did, indeed, work a change in certain of the regulatory policies theretofore applied by the Commission. It is here further conceded that the change was favorable to the railroads and in the direction of greater freedom of competitive pricing. But it did not go as far as the railroads then desired nor as far as the opinion below now concludes. Congress did not there turn the railroads loose upon their competitors without providing the counterbalancing restraint of Commission surveillance and jurisdiction, keeping constantly in mind the stake of the

shipping public in traditionally cheaper water transportation. To the contrary, it expressly rejected the "carte blanche" rate-making that the District Court would now confer upon appellees.

The change in fact wrought by Section 15a(3) – and, it is submitted, the only change – is clearly discernible and simply stated. The Commission, which admittedly had earlier vacillated between two divergent policies in intermodal rate controversies, was directed to adhere to that which based entitlement to protection upon merit rather than mere need. Prior to the enactment of Section 15a(3) in 1958, the Commission had frequently – but not invariably – restricted the ability of railroads to compete with other modes through rate reductions because of the anticipated impact of probable traffic diversion upon the services of the other mode. The barge lines were often accorded protection against railroad rate reductions and enabled to retain a "fair share" of the particular traffic by demonstrating nothing more than a *need* that rail rates be maintained differentially higher than those by water, if carriers by the latter mode were to attract any reasonable volume of traffic. *Sugar to Ohio River Crossings*, 296 I.C.C. 121 (1955), is illustrative of this line of cases in which reduced railroad rates were ordered canceled *without any consideration of which mode was the more economic in handling the involved traffic.*

During the same pre-1958 era, however, the Commission had also and earlier decided *New Automobiles in Interstate Commerce*, supra, discussed in *New Haven* and relied upon by the District Court in the second stated ground for decision below. In *New Automobiles*, in contrast to the "fair share of the traffic" or need for rate differential line of cases typified by *Sugar*, the Commission had equated intermodal competitive rate-making to demonstrated greater superiority and had declined to take action to allocate traffic upon the basis of need for a differential. This was a general investigation of rates and practices relating to the transportation of new automobiles by rail and motor carrier and, when in conjunction with one of the other two modes, by water car-

ier as well. The motor carriers asked the Commission "to lay down the principle that in meeting highway competition the railroads should in no instance go below the fully-distributed rail costs or the truck rates." (259 I.C.C. at 530) The railroads, on the other hand, asked for freedom to meet competition by reduced rates so long as out-of-pocket costs were met.

The Commission in *New Automobiles* undertook a comparison of carrier costs and found most rates to be compensatory. It denied a rate "umbrella" to the motor carriers for movements over 200 miles, finding that the rate parity sought by those carriers would "bring them much more of the long-haul traffic, although for such distances *they are least fit from a cost standpoint*." (254 I.C.C. at 539) (Emphasis supplied) As the United States emphasized in its Reply brief below, clearly in *New Automobiles* the Commission determined "the relative fitness of the various agencies of transportation" measured by cost. (p. 12) Based upon its findings, in the statement for which *New Automobiles* is most frequently cited, the Commission said:

> As Congress enacted separately stated rate-making rules for each transport agency it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, *there appears to be no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa.* (Emphasis added) App. 14, par. 3.

This is the language quoted by the District Court (App. 25) but, we submit that it does not lead to the result suggested in the opinion below. Certainly, *New Automobiles* does not stand for the proposition that compensatory rates are *per se* lawful (except in some vague "situations") as the lower court found. Moreover, even if it did, Congress did not so understand it, and obviously, the legislative history of Section 15a(3) is filled out by what was understood by Congress to be the principle of *New Automobiles*.

The District Court accurately related the role of *New Automobiles* in the enactment of Section 15a(3) but failed to grasp its significance. Thus, the opinion below states:

> "We do not think there can be any doubt that the underlying purpose of Congress in enacting Section 15a(3) was to direct the Interstate Commerce Commission to observe the original intent of Congress in 1940 and to restore and adhere to the policy set forth in *New Automobiles* with respect to the preservation of inherent advantages."

Having thus recognized that the policy of *New Automobiles* relates "to the preservation of inherent advantages," it is impossible to reconcile the District Court's ultimate conclusion that "Thus, in *New Automobiles*, the Commission indicated its understanding that Congress intended that carriers should normally be free to offer rates which were compensatory." Manifestly, where, as here, the "normal" freedom (where no issue of intermodal inherent advantage has been raised) to offer compensatory rates comes into direct conflict with the public policy aimed at preservation of intermodal inherent advantages the former must give way to the latter in accordance with the specific directive of Section 15a(3).

The fact that Congress understood the policy of *New Automobiles* to permit the assertion of inherent advantage (there referred to as the relative fitness of the various modes measured by cost) through competitive rate-making, as contrasted to the highly criticized line of protectionist decisions by the Commission, is made clear by the legislative history, including the very portions of the Senate Report quoted in the footnote to the discussion by the District Court in the opinion below, indicating that *New Automobiles* was understood to stand for *the right to assert inherent advantages*. (App. 26-27) The House Report is to the same effect. H. Rep. No. 1922, 85th Cong., 2d Sess., p. 14. Similarly, the Report of the Senate Committee on Interstate and Foreign Commerce described Section 15a(3) as "designed to encourage competition . . . by allowing each form of transportation . . .

full opportunity to make rates reflecting the inherent advantages each has to offer . . ." and went on to observe that such rate-making would be regulated by the Commission "to prevent unfair or destructive competitive practices as contemplated by the declaration of national transportation policy." (S. Rep. No. 1647, p. 3.)

It seems indisputable, therefore, as this Court recognized in *New Haven*, that Section 15a(3) was intended to eliminate "paternalism" and the role of the Commission as a "giant handicapper" and to substitute merit for need, demonstrated greater "relative fitness" for a "fair share" allocation of the market, and inherent advantage for competitive rate differential. Simply stated, therefore, the Congress, reaffirming the *New Automobiles* principle, said to the Commission in effect, henceforth, you may not arbitrarily "hamstring" the superior agency of transportation. In no respect, however, did the Congress deprive the Commission of the power to determine which carrier is the more fit and to take appropriate action where needed, to protect such inherent advantage from destructive competition. Indeed, the express incorporation of the National Transportation Policy in Section 15a(3), following the rejection of earlier more rail-oriented versions, enjoins the Commission to assume just that responsibility.

C. The District Court's Interpretation of Section 15a(3) Amounts to Enactment of "The Three Shall Nots" Previously "Explicitly Rejected" by the Congress.

The nature of the change in fact accomplished by Section 15a(3), from "fair share" allocation of traffic among the modes to a showing of inherent advantage as a condition precedent to invocation of the Commission's powers in intermodal controversies, is confirmed by the then proposed legislation which the Congress *did not* enact. This Court in *New Haven* discussed and recognized the significance of the legislation endorsed by the railroads, known as "the three shall nots". As originally recommended by the Secretary of

Commerce this draft legislation would have amended Section 15a(1) of the Act to provide that, in determining whether a rate is less than a reasonable minimum, the Commission

> "shall not consider the effect of such charge on the traffic of any other mode of transportation; or the relation of such charge to the charge of any other mode of transportation, or whether such charge is lower than necessary to meet competition of any other mode of transportation." (372 U.S. at 753-54)

Appellants here recognize that had "the three shall nots" received the approval of Congress they would have effectively ruled out any consideration by the Commission of the impact of the reduced rail rate upon water transportation, whatever advantages the latter might offer to the shipping public. Just as the District Court now holds, based upon its interpretation of Section 15a(3), "the three shall nots", vigorously advocated by the railroad industry, would have required the Commission in an intermodal controversy to approve any rail rate above out-of-pocket costs irrespective of its impact upon the inherent advantages of other forms of transportation.

As this Court observed in *New Haven*, the Commission and other carriers expressed vigorous opposition to the bill in this form. "When after hearings, a Senate Subcommittee recommended a bill to its parent committee, it *explicitly rejected* the three 'shall nots'." (372 U.S. at 754) (Emphasis supplied) It would seem clear, therefore, that if, as the District Court now holds "Congress has expressed a clear intent that reduced compensatory rates should normally be allowed. . . ." (App. 31-32), what better way to have made such an intent indisputably clear than by enactment of "the three shall nots"? The situation of a rail-water struggle and of the precise rate-cost relationship involved in *Ingot Molds*, provided the very context within which the Congress chose to reject the single mode standard embodied in the railroad supported "three shall nots", in favor of a standard of relative advantage calling upon the Commission to both measure

and, thereafter, if need be, protect the demonstrated lower cost form of transportation. Manifestly, Congress did not intend to leave the water carrier "family" entirely "defenseless" against below-full-cost rail rates as the lower court here concludes. To the contrary, as this Court likewise observed in the *New Haven* opinion, the Senate Subcommittee that had rejected "the three shall nots" had "expressed its concern with 'overregulation' and emphasized that its own proposal to add a new § 15a(3) was designed to encourage competition among the different modes and to permit each mode to assert its *inherent advantages*." (372 U.S. 754) (Emphasis by the Court)

Repeated use of the word "assert" in the legislative history indicates that the Senate Subcommittee obviously contemplated that each mode would be enabled to take affirmative action to both exploit its advantages and protect its traffic against diversion to other modes where it could satisfy the condition precedent of demonstrated superiority. The subsequent Senate Report reiterating and emphasizing the "import" of the Senate Subcommittee report quoted the following from the latter report:

> It nevertheless appears that the Interstate Commerce Commission has not been consistent in the past in allowing one or another of the several modes of transportation to assert their inherent advantages in the making of rates. The subcommittee recommends, therefore, that the Commission consistently follow the principle of allowing each mode of transportation to assert its inherent advantages, whether they be of service or of cost. In 1945 in New Autobiles in Interstate Commerce (259 ICC 475), the subcommittee believes that the Commission properly construed the intent of Congress in this respect when it said:
>
> > 'As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement

> of traffic by that agency. In other words, there appears no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa (259 I.C.C. at p. 238).
>
> The subcommittee wishes to affirm the interpretation of the Commission given in the Automobile case epitomized in the words quoted above. The subcommittee therefore believes it necessary to amend the act only so as, in effect, to admonish the Commission to be consistent in following the policy enunciated in the Automobile case thus assuring reasonable freedom in the making of competitive rates. * * *
>
> The subcommittee anticipates that the broad effect of this amendment will be to encourage competition between the different modes of transportation to the benefits of the shipping public. * * * S. Rep. No. 1647, 85th Cong., 2d Sess., pp. 2-3.

The foregoing extract makes it abundantly clear that Congress intended to legislate - and understood *New Automobiles* to represent - "the principle of allowing each mode of transportation to assert its inherent advantages, whether they be of service or of cost." Obviously, no such assertion is possible, in any event in the "normal" situation, under the ruling of the lower court here, which would preclude the Commission from protecting the inherent advantage of the barge-truck route against impairment.

The ensuing legislative history cannot be better summarized than it was by this Court in *New Haven* (372 U.S. 754-58). As there pointed out "the bill at this stage" provided that the Commission, in determining whether a rail rate protested by another mode is lower than a reasonable minimum, should consider the movement of traffic by railroad "and not by such other mode." Appellants must again concede, just as was true of "the three shall nots", that the District Court's declaration that compensatory rates, even where shown to adversely affect a more advantageous form of transportation, must be nevertheless approved by the Com-

mission, would apply to *Ingot Molds* had "the bill at this stage" been adopted. But Congress did not enact Section 15a(3) in this form. It was pointed out by the Commission through its Chairman in the hearings before the full Senate Committee, as this Court indicated in *New Haven*, that the then proposed 15a(3) with the "and not by such other mode" proviso attached was "substantially equivalent to the three 'shall nots'." (372 U.S. 754) The ensuing discussion by this Court in *New Haven* is particularly significant and we take the liberty of here quoting from it at some length because we deem it dispositive of the issue of statutory interpretation presented in this proceeding:

> ". . . In particularly Commissioner (then Chairman) Freas expressed concern that if the Commission were foreclosed from considering the effect of a rate on a competing mode, it would be powerless to reject a railroad rate which covered the railroad's out-of-pocket costs, even if that rate had the effect of destroying the inherent advantages of a lower-cost carrier. He stated:
>
> > " 'Whenever conditions permit, given transportation should return the full cost of performing carrier service . . . . In many instances, however, the full cost of the low-cost form of transportation exceeds the out-of-pocket cost of another, If, then, we are required to accept the rates of the high cost carrier merely because they exceed its out-of-pocket costs, we see no way of preserving the inherent advantages of the low cost carrier.' Id. at 168.
>
> "Commissioner Freas made it clear that the Commission believed the railroads should be permitted to assert their inherent advantages too, id., at 172, and suggested that any proposal specifically authorize the Commission to give 'due consideration to the inherent cost and service advantages of the respective carriers,' id., at 169. In further discussion, it was indicated that it would be inconsistent with the National Transportation Policy to permit destruction of the inherent advantages of any mode of transpor-

tation, id., at 170, 171, 177, and when Senator Potter suggested the deletion of the phrase 'and not by such other mode' and the addition of a reference to the National Transportation Policy, Chairman Freas answered: 'We will buy Senator Potter's suggestion.' Id. at 177, 178. Senator Potter's suggestion was adopted in the final version of the bill."

* * *

"This revealing legislative history fills out the contours of section 15a(3). There can be no doubt that the purpose of this provision was to permit the railroads to respond to competition by asserting whatever inherent advantages of cost and service they possessed. The Commission, in the view of the proponents of the bill, had thwarted effective competition by insisting that each form of transportation subject to its jurisdiction must remain viable at all costs and must therefore receive a significant share of the traffic. It had, in the words of one Congressman, become a 'giant handicapper.'

"Moreover, it is clear that Congress did not consciously or inadvertently defeat this purpose when it included in section 15a(3) a reference to the National Transportation Policy. The principle reason for this reference, as the hearings show, was to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes. And the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed costs, forced a smaller competing *lower cost* mode to go below its own fully distributed cost and thus perhaps to go out of business." (372 U.S. 754-55, 757-58) (Emphasis by the Court)

It must be abundantly clear that the opinion below, dealing in *Ingot Molds* with the "precise example given to the Senate Committee" completely nullifies the intended "power of

the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes." In thus interpreting Section 15a(3) the District Court has pursued a line of reasoning that is 180 degrees contrary to the "principal reason" for the reference in that provision to the National Transportation Policy which, as this Court pointed out, was to "emphasize the power" of the Commission in such circumstances. If, as the District Court concludes, Congress in fact intended "that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs." (App. 31), even in the "case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed costs, forced a smaller competing *lower cost* mode to go below its own fully distributed cost and thus perhaps to go out of business", then, it must follow that Congress performed a totally meaningless act in rejecting "the three shall nots" and equivalent language and, in lieu thereof, enjoining the Commission to give "due consideration to the objectives of the National Transportation Policy declared in this Act." Certainly, the District Court has erred in, by implication, attributing such illogical action to the Congress.

D. The District Court's Misinterpretation of Section 15a(3) Is Not Cured by the Reservation of Commission Jurisdiction in Unidentified 'Situations'.

It has previously been pointed out herein that the opinion below, in the Court's second stated ground for decision, "carves out" some areas, left entirely undefined, for the exercise by the Commission of the power otherwise denied it to cancel a rate in excess of out-of-pocket costs. Thus, it is said that "the Commission failed to take adequate account of the Congressional intent that carriers should *normally* be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs." (App. 31) (Emphasis supplied) And again at the same page in the concluding portions of the opinion below the District Court reiterating the same construction of Section 15a(3) concludes as follows:

> "We do not mean to suggest that their may not be *situations* where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory. What we do suggest is that Congress has expressed a clear intent that reduced compensatory rates should normally be allowed and that the record here and the Commission's report supply no basis for disregarding that intent." (App. 31) (emphasis supplied)

Attention is directed to the fact that the above-quoted penultimate paragraph represents the only reference by the District Court to possible Commission authority in special circumstances. Reserving for later discussion herein the question of the rationale of the Commission's action, it is noteworthy at this point to observe that the lower court apparently contemplates that the Commission *does* possess the statutory power to prohibit a compensatory rate under *some* circumstances. Even more significantly, the District Court attributes to the Congress, as a matter of statutory construction, the distinction between "situations", entirely vague but presumably unusual, in which the Commission has power to take action just like that which it took in *Ingot Molds*, and other situations (allegedly "normal") in which that Court has ruled that such power is lacking.

It must be obvious, simply as a matter of initial reaction to such an interpretation, that, were it sound, Congress has supplied no standards whatsoever as to when the Commission may act or when it is powerless to act. Neither does the opinion below provide any clarification as to what the District Court conceives to be the Congressional intent and policy in this respect. Lacking statutory standards, the transportation industry by all modes would be consigned to uncertainty and chaos and the duty of the Commission to promote a sound transportation system would become a virtual nullity. We submit that the powers of administrative agencies are not so nebulously defined. A proper interpretation of Section 15a(3) establishes that the Congress

did not intend to leave the Commission entirely "rudderless", in dealing with intermodal problems, with no standards to govern its exercise or, indeed, possession, of the power to take appropriate action to promote the objectives of the National Transportation Policy embodied in Section 15a(3).

The court below has itself been inconsistent in arriving at the strained and ineffectual interpretation of Section 15a (3) quoted above. For example, it states, referring to the question of "the relative efficiency of the competing carriers in carrying this traffic" that "This question is one of great importance in view of the Commission's obligation, declared in the National Transportation Policy and the rate-making provisions of the Act, to promote efficient and economical use of transportation resources and the establishment of rates which are as low as possible." (App. 19) Under the District Court's view of its powers it is difficult to see how the Commission can carry out the "obligation * * * to promote efficient and economical use of transportation resources" if a higher cost mode must be permitted to take rate action which impairs the ability of the lower cost mode to assert that inherent advantage.

Even more difficult of reconciliation with its conclusion is the District Court's entirely accurate recital of the finding of this Court in *New Haven.* Referring to that decision the opinion below states: "The Court also said that a reduced compensatory rate should not be found unlawful *unless this is necessary to preserve the inherent advantages of a competing mode.*" (372 U.S. at 758). (App. 23) (Emphasis supplied) Clearly this summary of the *New Haven* holding, in which we concur, is a "far cry" from the District Court's ultimate conclusion that "normally" the Commission has no power to prohibit a compensatory rate, assuming, *arguendo,* the validity of the Commission's finding that the rail rate on ingot molds was required to be cancelled for the very reason that such action was found "necessary to preserve the inherent advantages of a competing mode."

It must be clear that the foregoing *New Haven* principle, to which the District Court paid only "lip service", reflects the actual Congressional intent rather than the vague one of "on again - off again" power, dependent upon undefined "situations," provided by the lower court. Clearly, that court erred materially in failing to implement the statutory policy which the court itself recognized to be unmistakably defined in *New Haven*.

Railroad appellees, understandably apprehensive about the drastic curtailment of the Commission's powers accomplished in one fell swoop by the District Court, comment in their Motion to Affirm that it is "simply not so" as appellants are said to claim "that the lower court has laid down a rigid rule of law which deprives the Commission of its jurisdiction with respect to the recognition and preservation of the inherent advantages of lower costs." (Motion, p. 5). They then go on to assert, with obvious heavy and newfound reliance upon the word "normally", that "normally Section 15a(3) requires the Commission not to interfere with reduced rates which are compensatory and beneficial to the proponent mode" (the latter test was not imposed by the Court below) except "if the Commission articulates a rational basis for doing so." (Motion, pp. 5 and 6). Appellees' embellishments upon the ruling below, of course, attempt to soften the harshness of the District Court's opinion.

It is clear from the foregoing that the railroads, upon reading the opinion below, have no more idea than these appellants of what "situations" confer jurisdiction upon the Commission and what standards are to be applied in any such "situations." To dispose immediately of the irrelevant "straw man" that appellees upon motion seek to set up in order to place these appellants in an extreme posture, it should be made abundantly clear that we do not attribute to the District Court a "rigid rule of law." To the contrary, we confess complete ignorance as to what rule of law is there laid down for the determination of those "situations"

which confer power upon the Commission, said by the court below "normally" to be lacking. It is here further submitted the absence of both jurisdictional clarity and policy standards for the Commission's guidance under the lower court's interpretation of Section 15a(3) is itself demonstrative of the invalidity of that statutory analysis.

In the instant proceeding, however, it is further submitted that this Court need not concern itself with the "rigidity" or, alternatively, as we suggest, vagueness, of a rule of law for application in undefined extraordinary circumstances because the situation here is entirely "normal". This is the very intermodal competitive case of a rail rate fixed at a below full cost level identical with the barge-truck charges impinging upon the lower cost mode of transportation that the Congress had in mind in conferring upon the Commission in Section 15a(3) the power to carry out the objectives of the National Transportation Policy by prohibiting a reduced rate otherwise lawful. Whatever the rule of law in undefined special "situations", the opinion below is entirely clear and 100% rigid in denying to the Commission the power to prevent impairment of inherent advantage in the typically "normal" and, hence, vastly more important intermodal rate controversy found in *Ingot Molds.*

In this connection it might be added that we read the opinion below just as does the United States. The footnote at page 4 of the Memorandum For The United States herein states as follows:

> "[1] Although the district court's first ground of decision does not reach this question, it is necessarily presented because the second ground—that the Commission misinterpreted or misapplied the relevant statutory provisions—prohibits the Commission, except in extraordinary situations, from using fully distributed costs as the criterion for determining inherent advantage between competing modes."

There can, accordingly, be no disagreement that the District Court has effectively foreclosed one of the possible measures

of inherent advantage—full costs—expressly left to the Commission for "initial resolution" in *New Haven.*

By way of further comment it may be speculated, admittedly without clues in the opinion below, that the District Court's reference to special situations for the exercise of the Commission's power was intended to correspond to the discussion by this court in *New Haven.* Reference is made in the concluding section of the *New Haven* opinion to the needs of commerce and the national defense as constituting an "operative policy" which might warrant special consideration by the Commission. This Court there made it clear, we believe, that under such extraordinary circumstances, the Commission might override "either the more particularized mandates of the National Transportation Policy or the clear Congressional design embodied in § 15a(3)." (372 U.S. at 762)

Such special considerations, this Court noted, once raised in an intermodal controversy, must be evaluated just "like the factor of inherent advantage" and "do not exist solely for the benefit of protesting carriers." (372 U.S. at 764). In effect, therefore, as *New Haven* makes clear, the true "normal" situation in an intermodal controversy is for the Commission to recognize and preserve any demonstrated inherent advantages, whereas, "under extraordinary circumstances", with specific findings, the Commission might even deny to the mode possessing the inherent advantage the right to assert that advantage. Manifestly, the clearly defined special exception to the general intermodal application of Section 15a(3) involving the needs of commerce or the national defense, recited in *New Haven,* does not contemplate that the Act be so interpreted as to preclude the Commission from recognizing and preserving inherent advantage in *every* case.

E. The Normal Rule in Intermodal Cases When the Issue Is Raised Is Not Compensatoriness but Assertion of Inherent Advantage.

The foregoing analysis of the legislative history and the opinion of this Court in *New Haven,* both of which are relied upon in the opinion below, compels the conclusion that the District Court based its statutory finding upon a misunderstanding as to the "normal" situation to which Congress was there addressing itself. The lower court, as previously indicated, finds that Congress intended "that reduced compensatory rates should normally be allowed." (App. 31-32) As a general proposition, *where no inherent advantage is threatened,* appellants are prepared to concede that the lower court was entirely correct.

The *Ingot Molds case,* however, did not present a "normal" situation in this sense. The court's difficulty arose from applying that general rule whereby only improvident rates are beyond the scope of managerial discretion to an intermodal controversy, which placed directly in issue the question of whether the general right to publish a rate measured by out-of-pocket costs should give way to the public policy reflected in the National Transportation Policy and expressly incorporated into Section 15a(3). Once the intermodal issue is raised by a competitor's claim of entitlement to protection against the reduced rate, we submit that the *initial inquiry* is not the purely mechanical measurement of the proposed rate against the proponent's out-of-pocket costs, but rather the relative measurement, by use of an appropriate standard, of which mode possesses and is, hence, entitled to "assert", the inherent advantage of lower cost.

The footnotes appended by this Court to its opinion in *New Haven* are particularly pertinent to this discussion. Footnote 12 (372 U.S. at 760), referring to the measurement or protection of inherent advantage, states as follows:

> "[12] It was argued below, and at least intimated here, that the railroads had failed to sustain the burden of proving that they had the relative cost advantage.

> But we agree with the court below that if a carrier shows a proposed rate to be just and reasonable from the standpoint of its own revenue requirements, it is for a protesting carrier who relies on a claim of inherent cost advantage to bear the burden of persuading the Commission of the existence of that advantage. Of course, when such an issue is raised, each carrier should bring forward the data relating to its own costs that are required for resolution of the issue. See various Commodities from or to Ark. and Tex., 314 I.C.C. 215."

Clearly this Court recognized above that the "normal" situation, wherein "a carrier shows a proposed rate to be just and reasonable *from the standpoint of its own revenue requirements*" (emphasis supplied), is non existent when a competing mode raises the issue and assumes the burden of proving that it possesses an inherent cost advantage. Under the District Court's contrary interpretation of Section 15a (3), once the railroads have accomplished the first step in Footnote 12 by showing the rate to be compensatory, there is no "issue" remaining for resolution by the Commission. Patently, the lower court is in error in confusing the "run-of-the-mill" situation of a rate proposal lacking any intermodal competitive impact, with the typical and normal competitive situation that was the particular subject of Section 15a(3), i.e., an intermodal rate controversy placing directly in issue conflicting claims of inherent advantage.

Footnote 13 appended to the *New Haven* decision (372 U.S. at 760) likewise spells out the foregoing distinction which we suggest the District Court failed to appreciate. This Court said there:

> "[13] The utility of the concepts of fully distributed and out-of-pocket costs may be limited to the area in which they have tradionally been used—that of determining the reasonableness of a rate from the standpoint of a carrier's own revenue requirements. If so, some different measure may be preferred for comparing the costs of two or more modes of transportation."

Plainly, as this Court there observed, the standards of lawfulness where the test is mere compensatoriness, and those when the measure is inherent advantage, are not necessarily the same. Congress frequently has seen fit to prescribe varying standards in the Act, for example Section 4 requires that rates proposed thereunder be "reasonably compensatory", interpreted to require something more than mere coverage of "bare-bones" out-of-pocket costs. The Commission in using fully distributed costs as the measure of inherent advantage was not dealing with the situation in which out-of-pocket costs represent the "normal" measure of reasonableness "from the standpoint of a carrier's own revenue requirements". Rather, it was dealing and we shall hereinafter demonstrate, dealing reasonably, with the fundamental and primary issue in an intermodal controversy of determining wherein lies the inherent advantage, if any, of lower cost.

To summarize, therefore, it is our position that Section 15a(3) was intended to apply specifically to intermodal rate controversies such as are present in and typified by *Ingot Molds*. Where no issue of inherent advantage has been raised by a competing mode the District Court is correct, although wide of the target, that Congress intended to leave the carriers free to publish lawful rates which, *by interpretation of the provisions of the Act* (e.g. Sections 1(4) and (5) and 15(7), have been held to be those at a compensatory level. That, however, is not the *Ingot Molds case*. On the other hand where, as here, just as in this Court's Footnote 12 in *New Haven*, a protesting carrier by another mode raises an issue of inherent advantage, we urge that the District Court has erred in holding the Commission to be powerless to resolve that issue.

To the contrary, if the Commission is to carry out the objectives of the National Transportation Policy it must be empowered to utilize its administrative expertise in that endeavor. There is no reason to here require that it apply a standard developed for the distinct purpose of judging

whether a rate is compensatory. The primary inquiries under Section 15a(3) are to first determine, i.e., recognize, the existence of an inherent advantage and, thereafter, if required in the public interest, protect, i.e., preserve, that advantage. At this point in the administrative process the lower cost or inherent advantage mode becomes the ratemaker in the sense that it is entitled to be protected against rate action by other modes which the Commission finds will impair the former's inherent advantage. Had the railroads here been found to be the inherent advantage mode of transportation, that is, by the standard applied by the Commission, had they established the lower-fully distributed costs, they might then have elected to reduce their rates below that level. But where, as here, the barge-truck service was found to possess the inherent advantage, upon the requisite showing of adverse impact, it was entitled to protection against the rail reduction irrespective of the fact that the reduced rail rate, measured by standards applicable in other than intermodal competitive situations, may have complied with the requirements of law.

Congress recognized, in the examples twice recited by this Court in *New Haven*, that a compensatory rail rate below the rails' fully distributed costs might force a smaller competing lower cost mode to go below its own fully distributed cost and thus perhaps go out of business. It was the express purpose of the reference to the National Transportation Policy in 15a(3) to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes in just such a situation. The erroenous interpretation of that section by the District Court in the opinion below would improperly deprive the Commission of such power in the very circumstances most feared by Congress. Moreover, the *assertion* of inherent advantage that it was the Congressional purpose to assure—for all modes—is not fostered, but, rather, impeded, by the second stated ground of the District Court, which we urge this Court to unequivocally reverse.

III.

The District Court Erred in Finding the Commission's Order To Be Without a Rational Basis.

A. The Commission's Reports Together Clearly, If Succinctly, Reject Incremental Costing for Failure To Reflect Constant Costs.

In the foregoing discussion of the Commission's power under Section 15a(3) to prohibit a reduced, compensatory, rail rate in order to preserve the demonstrated inherent advantage of a competing mode, we have necessarily deferred consideration of the Commission's findings in implementation of what it conceived to be its functions under that provision of the Act. In what is actually the first stated ground for decision the court below "concluded that the Commission's order must be set aside . . . because it lacks a rational basis and thus is arbitrary. . . ." (App. 17)

The District Court's reasoning in reaching this conclusion is set forth in the ensuing pages of the opinion (App. 18-25) where it is made clear that the court had particular reference to the Commission's adoption of fully-distributed costs as the measure of relative rail-water inherent advantage. Thus, the opinion below holds, apparently assuming, *arguendo*, the power of the Commission to employ some standard and make some determination of inherent advantage, "that the Commission has failed to state a rational basis to support its conclusion that the 'fully distributed' costs of the two competing modes must be compared to determine which mode has an inherent cost advantage." (App. 18)[2]

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[2]It is interesting to note that the railroads, which now, of course, adopt the District Court's construction of 15a(3), heretofore devoted their primary efforts, not towards, disputing the Commission's power, but rather towards urging "incremental" costs as the standard in exercising that power. As recently as the oral argument before the Dis-

Appellants certainly concede that the decisions of an administrative agency must reflect its consideration of the pertinent evidence and principal issues sufficiently to eliminate any doubt as to the basis for its decision. We submit that this Court will find upon independent evaluation of the Commission's decision herein that it conforms to these fundamental requirements of administrative due process. The Commission was well aware that the *Ingot Molds* proceeding was launched to provide finalization of the intermodal issues first before this Court in *New Haven.* There, consistently with the Congressional purpose in enacting Section 15a(3), pure protectionism, without the evidence necessary for a finding of inherent advantage, was set aside as a reversion to the Commission's pre-1958 "handicapper" policy. The water carrier costs necessary to a comparison with rail costs and consequent measurement of the inherent advantage of lower cost, were lacking in *New Haven.*

In *Ingot Molds,* however, the missing cost elements were supplied and the Commission made specific findings as to both rail and water carrier costs which are not here disputed. In dealing with the evidence the Commission made it indisputably clear, through frequent reference to the *New Haven* decision, that it was there undertaking to follow the guidelines laid down by this Court and to formulate the "initial resolution" of the issue of inherent advantage delegated to it in that opinion. It did so, as we have previously emphasized, in the precise factual situation of a railroad establishing

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trict Court, railroad counsel, after referring to *New Haven* in emphasis of the Commission's obligation to resolve the problem of inherent advantage, concluded by stating: "notwithstanding the fact that they [the Commission] had before it all of the economic testimony, they have selected an approach for preserving the inherent advantage diametrically opposed to it." (Tr. 34)

Now they will undoubtedly contend that the Commission is powerless to select any approach for preserving inherent advantage at all, but, rather, must automatically place its stamp of approval upon compensatory rates.

a compensatory rate below its fully-distributed cost and thereby forcing a lower cost competitor to either establish an unprofitable rate or surrender the business, which motivated the Congress to incorporate the National Transportation Policy objectives into Section 15a(3). Moreover, it did so by reiterating the established full cost measure of inherent advantage only recently considered in detail in the *Grain* case.

The parties plaintiff before the District Court laid great stress upon the testimony of the so-called "four economists" for the railroads, urging that such testimony had been ignored and contending further, apparently, that the Commission's decision had not treated of this subject in sufficient detail. The District Court was obviously influenced by these arguments to conclude that the Commission had left it "completely in the dark" on certain matters and had failed "to set forth adequate reasons to support its own approach." (App. 20) We submit that the opinion below imposes an unreasonably harsh standard of report writing upon the Commission.

At the outset it must be recognized that none of the measurement concepts here before the Commission were novel. The out-of-pocket and fully distributed costs of record were developed in the conventional manner by use of the Commission's own formula which had been referred to and relied upon in innumerable cases. This Court in *New Haven* discussed both of those cost computations as alternative possible measures of inherent advantage and left it to the Commission to choose which of them, or whatever other evaluation, it might determine to be reasonable. The Commission's decision was likewise rendered in the light of the legislative history of Section 15a(3), the opinion of this Court in the *New Haven* case, and a comprehensive summary of the *Ingot Molds* record.

It is submitted that there is no principle of administrative law calling for the rendition by an administrative agency of a detailed treatise in support of its findings. In *Baltimore*

& Ohio R. Co. v. U.S., 298 U.S. 349, 359 (1936) in considering a Commission decision in a so-called division case, the Court held:

> "There is no requirement that the commission specify the weight given to any item of evidence or fact or disclose mental operations by which its decisions are reached. Useful precision in respect of either would be impossible. And it would be futile upon the record to attempt definitely to ascertain the weight assigned to any fact or argument in prescribing the divisions."

So long as sufficient details are recited to make abundantly clear the basis of the Commission's ultimate findings, the agency is not compelled to report special findings as to underlying or subordinate facts as a prerequisite to the validity of its order. *C.B. & Q. Ry. v. United States,* 6 Fed.Supp. 580, 584. A failure by the Commission to make a complete discussion of all the testimony or arguments brought forward by the parties, even if that were here the case, is not grounds for holding the Commission's order to be invalid. *Old Colony Furniture Co. v. U.S.*, 95 Fed.Supp.507, 510.

In any event, as we shall demonstrate, the report of the Commission, coupled with the prior findings of Division 2 expressly incorporated therein by reference, fairly sets forth the basis for the Commission's decision. Succinctness should not be declared a defect. Even if its conclusions might perhaps have been enunciated in greater detail, an order is not rendered invalid by being less comprehensive than it might have been. *N.Y.C. & H.R.R.R. v. I.C.C.*, 168F.Supp.131.

Division 2, in its report, gave full consideration to the railroads incremental cost theory as expounded by the four economists presented on their behalf. That report, under the heading of General Discussion and Ultimate Conclusions, disposed of the railroads' suggested test of inherent advantage by finding that:

> "For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the nation's transpor-

> tation system is to be healthy. Thus, whenever competitive carriers of different modes assert cost advantages inherent to their respective modes, we have recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is reasonably practicable to apportion* * * We adhere to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented. Stated differently, we recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced herein by respondents ignores them. We decline to so limit our rate-making powers." (App. 40-41)

Division 2 then went on to point out that, having made a determination of inherent advantage, the next issue for resolution was whether or not "a competing rate is destructive of such an advantage." (App. 41)

The District Court, in characterizing a paragraph quoted from the Commission's report as being the only reference therein "to the question of the relative efficiency of the competing carriers in carrying this traffic" (App. 19), ignores the foregoing discussion by Division 2 which the entire Commission subsequently adopted. To this effect the Commission quoted the language from the prior report of Division 2 recognizing fully distributed costs as the only sound standard of measurement of inherent advantage in intermodal controversies and expressly stated "We agree." (App. 66) Most significantly, the Commission preceded this discussion by quoting from the *Grain* case, where it said:

> "Although the fully distributed cost standard requires an arbitrary assignment of constant costs to particular traffic, that standard has generally been employed in measuring inherent cost advantages in intermodal competitive rate controversies." (App. 65-66)

We submit that the basis for the holding is there made abundantly clear and that resort to such a "shorthand" method of writing is not equivalent to a complete absence of rationale as the opinion below concludes.

B. The Railroads' Incremental Cost Theory Would Offset the Water Carriers' Inherent Advantage of Substantially Lesser Overhead Costs.

The crux of the cost comparison problem presented to the Commission in *Ingot Molds* is found in the fact that the the railroads have proportionally greater constant overhead costs than do competing modes of transportation, particularly water carriers. Hence, the spread between the rails' out-of-pocket or incremental costs and their fully-distributed costs of handling particular traffic is generally substantially greater than for the other modes. It is the railroads' position that their heavier constant costs should be ignored in determining which mode has the inherent advantage and should even be treated as beneficial. In essence, this argument boils down to the claim that, in comparing relative *advantages*, the Commission should act as a "handicapper" in a different fashion by eliminating a major *disadvantage* from the equation. In so doing, of course, the fundamental inherent advantage of the water carrier, a right-of-way provided by nature, would be substantially offset.

The railroads' claim that heavy constant costs are an advantage, if taken literally, would suggest that a carrier can improve its competitive posture by adding overhead expenses, an illogical argument that leads directly to bankruptcy. Clearly, they don't mean this; what the railroads actually mean is that the spread between their out-of-pocket and full costs would be an advantage, if out-of-pocket pricing is forced upon the Commission, in that it can be used to nibble away at competitive traffic by electing to forego the complete recovery of constant costs on that traffic. Even assuming, arguendo, that this theory might be beneficial to the railroads themselves, *so long as it is not applied to too much traffic*, the question remains whether it is beneficial to the public and consistent with the objectives of the National Transportation Policy.

As Division 2 found in its report, constant costs actually exist. Ignoring those costs by using incremental or out-of-

pocket costs as the measure of the inherent advantage will not cause the constant costs to disappear—only the competitor's inherent advantage is concealed by this election. For that reason, the Division's report expressly recited its adherence "to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented" (App. 41) and the Commission stressed the general full cost standard most recently reiterated in the *Grain* case. (App. 65-66)

To the same effect, the report of the Commission expressly disagreed with the railroads' incremental cost standard as a valid measure of inherent advantage, stating that—

> " . . . merely because a carrier is able, without incurring out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, does not necessarily mean that the carrier is the more efficient of the two." (App. 67-68)

Obviously, even the higher cost of the two modes, lacking the inherent advantage, may *benefit* from capturing traffic that the more economic utilization of the nation's transportation resources dictates should move by the lower cost mode, but that does not alter the relationship between the two or shift the inherent advantage from one to the other.

C. At Most the Four Economists Showed Incremental Pricing To Be Good for the Railroads.

The Commission, as previously indicated, fully considered the railroads' argument, based upon the testimony of the four economists, that adding traffic which contributes anything above incremental costs toward the carriers' overhead increases the profits of that carrier. We are not prepared to concede that incremental pricing is beneficial *even for the railroads* over the long run. As Division 2 appropriately recognized "full costs in the aggregate must be obtained" if carriers are to remain "healthy". (App. 40) Neverthe-

less, even if it be assumed, as did the Commission, that the four economists are correct and that the Pennsylvania and Louisville & Nashville Railroads improved their immediate "profits" by capturing the ingot molds traffic from the barge lines by the subject rate reduction, the shipper didn't save one cent. Such a showing can hardly be demonstrative of the public interest in developing and preserving adequate and efficient transportation. Clearly Congress did not intend, in expressly directing the Commission to give due consideration to the objectives of the National Transportation Policy, that it concern itself solely with what might be good for the railroads, particularly if accomplished only at the price of impairing the inherent advantage of another mode.

Even assuming a short-term advantage to the proponent mode from incremental pricing, manifestly constant costs are real and significant and must eventually be recovered from some source. The incremental or added traffic cost theory here espoused by the railroads, however, would not allocate any overhead costs to a car added to a train as a consequence of capturing new traffic on the theory that the train would operate in any event. But this same argument can appropriately be made by the shippers of every other car in the train who might, accordingly, also reasonably demand incremental pricing. Thus, the theory ignores the fact that, by definition, constant costs represent the indivisible aggregate expense of handling *all* cars, including those successfully diverted from other modes, not just the "other" cars that the railroads would prefer to consider at some other time as they deal with each competitive commodity in them on an incremental cost basis.

The opinion below indicates that the District Court, just as did the four economists, approached the problem solely from the standpoint of the individual self interest of the railroads or the "carriers' own revenues requirements" to employ the phraseology of *New Haven,* rather than in terms of the broader objectives of the National Transportation Policy. Thus, the court below stated:

> "We note that in the situation before us the Commission found not only that the reduced rail rate would be compensatory, but that it would produce greater revenues in excess of out-of-pocket costs than would the former higher rate. The reduced rate therefore will not be detrimental to the railroads' revenue requirements. In these circumstances and in light of the inadequacy of the Commission's report with respect to the recognition and preservation of inherent advantages, we are of the belief that *New Haven* provides no support for the Commission's order. (App. 23)

Clearly, the court's language above ignores the distinction so plainly stated in *New Haven,* particularly in Footnotes 12 and 13, between the test from the standpoint of a carrier's own revenues and that from the standpoint of an intermodal dispute over a claimed inherent advantage. In lieu thereof the District Court invokes a new standard under Section 15a(3), utterly without precedent, i.e., that a reduced rate be approved so long as it is not "detrimental to the railroads' revenue requirements."

A fair reading of both reports of the Commission, which together represent the Commission rationale except to the extent that the former was reversed by the latter, demonstrates that the questions as to which the District Court found itself "completely in the dark" were in fact resolved by the Commission. Turning to the first of these (App. 20), certainly the circumstances in which a carrier with lower out-of-pocket costs is the less "efficient" is the very situation here presented where the competing mode has a natural advantage and is, accordingly, the lower cost mode overall. The concept of inherent advantage contemplates a comparison of *two* modes. The maximum of overhead contribution by *one* mode, hypothesized by the court below in its question, is but half of the equation. Thus, the court's question answers itself when the other half of the comparison is added.

Similarly, the explanation sought by the District Court of "*why the standard* chosen by the Commission *measures* which carrier is more efficient in providing the service here involved" (App. 30) is furnished by the finding of Division 2, expressly adopted by the Commission, that out-of-pocket costs ignore the existence of constant costs which must be recovered if carriers are to remain healthy. (App. 40) It seems perfectly obvious that the Commission is here saying that the relative superiority of an enterprise, an entity, from the standpoint of deciding which mode best serves the transportation needs of the nation and merits preservation over the long run, is not to be made by a comparison which omits the constant costs which are incurred and must be recovered if a carrier is to continue to serve the public.

D. The Railroads' Economic Testimony Was Considered and Rejected - Not Ignored.

The criticism of inadequate consideration is equally as unwarranted as that of inadequately rationalized findings. The ultimate demonstration of the fact that the Commission did not ignore the economic testimony presented by the railroad appellees, but, rather, fully considered the evidence of the four economists is to be found in the unmistakable rejection of those contentions previously described. Manifestly, to disagree is not to ignore. Even where certain testimony has not been discussed in a Commission report, but the reasons for rejecting it are stated, it has been held that such action does not constitute ignoring the evidence. *Columbia Transp. Co. v. U.S.*, 167 F.Supp. 515. As the court there pointed out, failure to give the evidence the weight claimed for it by a party does not amount to ignoring that evidence. Having here considered the evidence of the four economists, which constituted the heart of the railroads' contention for the out-of-pocket test of inherent advantage, and having rejected that testimony for reasons clearly stated in the Commission's reports, it necessarily follows that the Commission's opinion cannot fairly be said to be lacking a rational basis for decision. It would seem that the Dis-

trict Court simply failed to follow the reasoning of the report - and/or does not agree with it - but neither of these circumstances are grounds for setting it aside.

E. The Commission, Having Recognized the Inherent Advantage of the Barge-Truck Mode, Soundly Evaluated the Appropriateness of Protective Action.

Having set forth its reasons for adhering to the *Grain* case standard and selecting full costs over incremental costs as the measure of inherent advantage within the meaning of the statute, the Commission quite properly then applied itself to a determination of whether the inherent advantage thus found to lie with the barge-truck route was endangered by the proposed reduced rail rate. Here again the rationale of the Commission is abundantly clear. This consequential inquiry is again consistent with the guidelines laid down by this Court in *New Haven*. After discussing the possible appropriate methods of deciding which of two competing modes has the cost advantage on a given movement, this Court there stated:

> "And even if the cost advantage on each movement were determined to lie with the coastwise carriers, it may be that some or all of the TOFC rates at issue here should be allowed to stand because they would not unduly impair that advantage." (372 U.S. at 760-761)

Expanding upon this principle, Footnote 14 to the foregoing sentence in the *New Haven* case contains an illustration of a situation in which a reduced rate by a competitor is found *not* to impair a marked inherent cost advantage.

The Brief of the United States in the *New Haven* case urged to this Court that an inherent cost advantage is impaired—

> "when the low cost carrier is unable to fix a rate which (a) covers its fully distributed cost and (b) affords it a rate advantage (as against the high cost carrier) which is no less than the cost differential (measured in terms of fully distributed cost) by the modes."

This suggested standard of ratemaking is obviously more restrictive than that adopted by the Commission in *Ingot Molds* since the order in the latter case did not prescribe a rate differential but simply ordered the cancellation of an unlawfully low rail rate. Reference to the Department of Justice position in *New Haven* is significant, however, in dispelling any suggestion of arbitrary action by the Commission in taking the latter action.

The example from the legislative history discussed in *New Haven* likewise constitutes a recognized situation in which a inherent advantage may fairly be said to be impaired. Finding here that the railroads' reduced rate was below the full costs of the barge-truck mode, just as in the *New Haven* example, the Commission properly concluded that it unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. In declining to approve the rate reduction the Commission said that "To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation." (App. 71) Certainly the rationale of this finding is abundantly clear in the Commission's reports. It is not a question, as the District Court suggests (App. 24) of the availability of water transportation on ingot molds alone. The Commission was well aware that it was here dealing with a "test case" and took pains to point out the limited commodities for which rail and barge service compete and the greater reliance by the latter upon the eleven commodity groups accounting for 81.45% of the total barge revenue. (App. 31, 68)

It was, obviously, clear to the Commission and should certainly be apparent in reviewing its reports that it viewed the impairment of inherent advantage, typified by the ingot molds rail rate reduction, as being the mechanism through selective rate-cutting for destruction of the water carriers. As the Commission stated, after pointing to the vulnerability of the barge lines in terms of reliance upon a few commodity groups: "In short, an inherent cost advantage under

the national transportation policy reasonably could not embrace a concept that would impair the ability of a carrier not only to compete but to exist." (App. 68) Manifestly, out-of-pocket pricing by the railroads on such important commodities could readily "deprive shippers of cheaper water transportation", as the Commission thereafter concluded. (App. 68, 71)

Anyone viewing the intensity of the railroad campaign, first, for "the three shall nots" and subsequently, in this *Ingot Molds* proceeding, who does not recognize the railroads' incremental cost theory as a vehicle for the serious impairment, if not extinction of the water carriers, is simply closing his eyes to the realities of the situation. The Commission, in its expertise, was not so naive as to fail to recognize that the impairment and possible loss to the shipping public of cheaper water transportation was here involved. Accordingly, it took appropriate steps to prevent destructive rate action in fulfillment of its obligation under the National Transportation Policy to preserve inherent advantages and encourage efficient and adequate transportation by all modes. One may disagree with that judgment, as the railroads undoubtedly do, but the Commission's reasoning is plainly set forth in its reports and is not validly to be faulted for lack of a stated rationale.

IV.

Recognized Principles of Judicial Review Clearly Warrant Approval of the Commission's Order.

The foregoing analysis of the Commission's reports demonstrated, we submit, that this is a particularly appropriate proceeding for invocation of the rule of administrative expertise. The Commission was presented in *Ingot Molds* with the very issues and, as it later developed, the typical factual situation, that this Court said in *New Haven* should be left to that agency for "initial resolution." Clearly, both the Congress and the *New Haven* guidelines viewed the measure-

ment of inherent advantage called for by Section 15a(3) as embodying complex issues that the Commission is uniquely equipped to handle. Under these circumstances, even more than in the conventional appeal from an administrative decision where no such prior guidance has been provided, the lower court, whatever its own judgment on the merits of the issues presented, should properly have given great weight to the Commission's findings, and, we submit, erred in failing to do so. It is further urged that this Court undertake an independent appraisal of the Commission's order, applying the accepted standards of judicial review. We are convinced that such an evaluation will be persuasive that the administrative expertise reflected in the *Ingot Molds* reports should be left undisturbed by the courts.

The standards to be applied in reviewing an order of the Interstate Commerce Commission have been so frequently and so clearly defined in a virtually endless procession of cases that normally little comment on this subject is required. A particularly appropriate exposition of the principles of judicial review is found in the following language by the court in *Brotherhood of Maintenance of Way Employes v. United States,* 221 F.Supp. 24, aff'd Mem., 375 U.S. 216 (1963):

> "In this lawsuit, our review of the Commission's action is a limited one. We do not start anew and, on the basis of our judgment, determine whether acquisition of control of the B & O by the C & O should be approved. Congress has committed that judgment to the discretion of the Commission. *Minneapolis & St. Louis R. Co. v. United States,* 361 U.S. 173, 188-189. We are limited to determining whether any errors of law were made by the Commission; whether its action was arbitrary, capricious, or an abuse of its discretion, and, upon review of the whole record, whether its findings of fact are supported by substantial evidence. Title 5, U.S.C.A., Section 1009(e); *Universal Camera Corp. v. NLRB,* 340 U.S. 474, 95 L.Ed. 456. See also, *General Motors Corp. v. United States,* 207 F.Supp. 641,

643-644 (E.D. Mich. 1962); *United States v. Pierce Auto Freight Lines,* 327 U.S. 515, 90 L.Ed. 821; *Mississippi Valley Barge Line Co. v. United States,* 292 U.S. 282, 78 L.Ed. 1260. If the findings of the Commission are supported by substantial evidence on the whole record, we may not set them aside. Likewise, the weighing of the evidence is reserved exclusively for the Commission, *United States v. Carolina Freight Carriers,* 315 U.S. 475, 490, 86 L.Ed. 971, 983. It is not within the province of the reviewing court 'to substitute inferences of its own for those drawn by the Commission from testimony and * * * to weight anew conflicts in it.' *Chicago St. P., M. & O. R. Co. v. United States,* 322 U.S. 1, 3, 88 L.Ed. 1093, 1095.

In the earlier leading case on this subject to which the Court there referred, *Minneapolis & St. Louis R. Co. v. United States,* 165 F.Supp. 893, 897-98, aff'd 361 U.S. 173, (1959) the court stated—

> "That this Court would or might have arrived at a different conclusion, had it had the duty and responsibility of deciding the controversy between the applicants, is of no consequence.
>
> "It must be remembered that, within the limits of the jurisdiction conferred upon it, the power of a court or an administrative agency to decide questions is not confined to deciding them correctly. *Thompson v. Terminal Shares, Inc.,* 8 Cir., 89 F.2d 652, 655; *Pittsburgh Plate Glass Co. v. National Labor Relations Board,* 8 Cir., 113 F.2d 698, 701.
>
> " 'A controversy like this always calls for a fresh reminder that courts must not substitute their notions of expediency and fairness for those which have guided the agencies to whom the formulation and execution of policy have been entrusted.' *Railroad Commission of Texas v. Rowan & Nichols Oil Co.,* 310 U.S. 573, 580-81; *Pittsburgh Plate Glass Co. v. National Labor Relations Board, supra,* 113 F.2d at page 701."

To the same effect, in *Navajo Freight Lines v. United States,* 186 F.Supp. 377, 383 (D. Colo. 1960), the Court, discussing the Commission's finding, with respect to a transaction under Section 5(2)(b) of the Act, of consistency with the public interest, stated

> "Because of its expertise that body is equipped to resolve all factors and reach a conclusion that conforms to the declared national transportation policy.

The above-quoted principle is particularly appropriate to the instant proceeding inasmuch as the Commission's expertise was here applied, pursuant to the directive of this Court in *New Haven,* to an issue under the National Transportation Policy which the Congress in enacting Section 15a(3) clearly intended to refer to that agency. The Commission, carrying out its duties under that provision of the Act, applied this expertise to the complex problems before it and came up with a solution, i.e., the application of fully-distributed costs as the measure of intermodal inherent advantage. Appellees, and, indeed, the District Court, are free to disagree with the Commission's judgment in electing this standard, but that does not constitute a valid basis for setting aside the Commission's order. Where the Commission made unmistakably clear, as we have demonstrated above, the basis for its determination, and, where, as here it has exercised its expert judgment to select one of the alternative cost standards that this Court indicated in *New Haven* was open to it, the charge of arbitrariness leveled by the District Court cannot be sustained.

In a very recent pronouncement upon the scope of judicial review in an Interstate Commerce Commission proceeding, *Penn-Central and N & W Inclusion Cases,* 19 L.Ed. 2d, 723, decided January 15, 1968, this Court said:

> "With respect to the merits of the merger, however, our task is limited. We do not inquire whether the merger satisfies our own conception of the public interest. Determination of the factors relevant to the public interest is entrusted by the law primarily

> to the Commission, subject to the standards of the governing statute. The judicial task is to determine whether the Commission has proceeded in accordance with law and whether its findings and conclusions accord with the statutory standards and are supported by substantial evidence."

The problem, spelled out in *New Haven,* of first, measuring, and thereafter, if need be, protecting, (372 U.S. at 760) the inherent advantage of a given mode in an intermodal rate controversy, assigned to the Commission by Section 15a(3) is no less complex than the intricate railroad mergers before the Court in the case last cited. Application to *Ingot Molds* of the same principles of judicial review there most recently applied compels the conclusion, we submit, that the doctrine of administrative expertise is nowhere more appropriately applied than here. It follows that the District Court erred in here setting aside an order of the Commission entered in full compliance with the requirements of administrative due process.

V.

The Public Interest in Preserving Inherent Advantages in Transportation and Assuring Adequate Service by All Modes Requires That the Policy-Making Role of the Commission Be Reestablished in This "Test" Case.

The fact that the critically important issues presented upon this appeal arise generally within the context of a rail-barge adversary proceeding should not be permitted to obscure the more fundamental fact that the ultimate interest here, as in all controversies under Section 15a(3) of the Act, is that of the public. It is so basic that there is sometimes a tendency to forget that the National Transportation Policy was enacted as a guide to the actions of the Interstate Commerce Commission, not so that water carriers or railroads or other interested parties might prosper, although, of course, the profit motive is the key to our capitalist economy, but so that this nation might be assured the best possible trans-

portation system by all modes adequate to the needs of commerce and the national defense. It was recognized that such a transportation system could most economically be developed only if each mode were encouraged to provide that service which it is best equipped to perform.

Coming more particularly to the mandate of Section 15 a(3), optimum utilization of the nation's resources necessarily requires that, where inherent advantages in transportation exist, they should be preserved in the public interest. It is equally fundamental to this concept to recognize that the major waterways of the nation, notably the Ohio and Mississippi River Systems, constitute valuable natural resources for many purposes, among them transportation. Otherwise stated, in admittedly simple and unsophisticated terms, the water carriers employing the rivers as a natural right-of-way have an advantage, obviously *inherent* to this method of transportation, over the railroads much of whose assets are "sunk" in their respective man-made rights-of-way.

Congress has not only recognized and indicated its desire to preserve inherent advantages, most especially when those advantages are reflected in lower costs of obvious benefit to the shipping public, it has also made abundantly clear its appreciation of the greater economic power of the railroads to impair the advantages of competitors. By way of illustration, Section 5(2)(b) of the Act, governing the acquisition of control of carriers, expressly imposes a more rigorous burden of proof upon railroads acquiring control of motor carriers, than, for example, upon motor carriers acquiring control of railroads, constituting clear recognition by Congress of the disproportionate power to suppress competition.

Similarly, and much closer to home, it has already been emphasized with respect to Section 15a(3), as ultimately enacted by Congress, that the reference therein to the National Transportation Policy was for the express purpose of giving the Commission the power to prevent a railroad, by reducing its rates below its full costs, from driving a

lower cost water carrier out of business. The intervention of all the nation's major railroads in support of the incremental cost theory of rate-making here involved should suffice to demonstrate that the same apprehension expressed by the Congress (and the Commission as well) at the time that "the three shall nots" were rejected, is still a valid consideration.

As we previously pointed out, the Commission in its reports was not so naive as to fail to recognize that the out-of-pocket measure of inherent advantage advocated by the railroads might threaten the very existence of the barge line industry. (App. 68) By the simple expedient of merely matching the barge-truck charges, the railroads succeeded, as they knew they would, in capturing the ingot molds traffic. The normal $11.86 rate theretofore maintained by the railroads on this commodity was continued in effect, *except between the points involved herein where barge competition exists.* The shipper of ingot molds, who, unfortunately, has no barge service available, continues to pay $11.86 and, accordingly, makes that contribution toward the railroad's constant costs which must be picked up by other shippers in order to make possible selective rate-cutting down to the out-of-pocket cost level. Recognizing that the railroads carry a wide variety of traffic much of which is non-competitive, whereas the barge lines rely almost entirely, as the Commission's report points out (App. 68), upon only eleven commodity groups, all of which are rail competitive, it must be obvious that the railroads have the power to indulge in intermodal rate cuts like that in *Ingot Molds* on a wide front.

The railroad appellees undertook below to justify incremental pricing on the ground that the ability to do so itself constitutes an inherent advantage and that the resultant lower rates are beneficial to the public. The Commission quite properly recognized the fallacy in this argument noting that constant costs exist and must be recovered in the aggregate *somehow* from *someone* if carriers are to remain "healthy." (App. 40) Assuming, however, that rates made

above out-of-pocket costs which attract additional traffic from railroad competitors are beneficial to the railroads, the basic issue which remains is one of the price to be paid by the public to enable the railroads to develop marginal revenues in this manner. We submit that where increased profits - if a constant cost contribution is considered to be profit - can only be realized by diverting traffic from a more economic mode of transportation, thereby jeopardizing the preservation of the latter's inherent advantage, the price to be paid by the public vastly exceeds any benefits. We believe that this is the distinction that this Court undertook to point out in Footnotes 12 and 13 in the *New Haven* case, that is, between a proposed rate made only "from the standpoint of a carriers' own revenue requirements", on the one hand, and, on the other, a rate which reflects the assertion of a proven inherent advantage over other competing modes. (372 U.S. at 760)

It is further submitted that the testimony of the four economists, so greatly stressed by appellees and referred to by the District Court, constitutes a reflection of nothing more than railroad self-interest in no way synonomous with public benefit. In essence, the justification for incremental pricing presented in this economic testimony is that the railroads, by reducing rates below full cost to the point necessary to divert traffic from other modes of transportation, however better equipped the latter to economically handle that traffic, may whittle away at their constant costs and thereby improve their overall profit picture. This theory necessarily assumes, of course, the existence of a reservoir of non-competitive traffic upon which the railroads may charge "all the traffic will bear" in order to make up the overhead deficit that would inevitably follow from substantial across-the-board below full cost rate-making.

All that the four economists have said is that, so long as traffic captured from other modes contributes anything over and above the added cost of handling that traffic, it is "money in the bank" for the railroads. But, unless Section

15a(3) is to be interpreted on some sort of "what's good for General Motors, is good for the country" theory, even if the economists are correct "from the standpoint of a carrier's own revenue requirements" that they will benefit from the proposed rate, this is not the test under Section 15a(3). The barge lines *and the public* will benefit more if inherent advantages of transportation, where they are demonstrated to exist, are preserved and fully exploited rather than impaired and possibly destroyed.

We further submit that under the mandate of the National Transportation Policy the Commission could not have done otherwise than to take seriously the responsibilities imposed upon it by the Congress and to conclude that, irrespective of possible benefits to the self-interest of the railroads, the overriding impaet upon the demonstrably lower cost water carriers, and, consequently, upon the shipping public, would not justify the relief sought by the railroads. Clearly, as this Court recognized in *New Haven,* if Congress had intended the Commission to close its eyes in dealing with a reduced rail rate to any consideration other than the benefit to be derived by the proponent carrier it had ample opportunity to have done so by enacting those railroad-endorsed versions of Section 15a(3) which it "explicitly rejected."

The role of the Interstate Commerce Commission in carrying out the objectives of the National Transportation Policy, would, of course, be seriously curtailed under the ruling of the District Court below. To so restrict the powers of the Commission will be to place the water carriers at the mercy of selective railroad rate cuts, which, if they follow the pattern of *Ingot Molds,* will not give the shipper a rate lower than that now offered by the barge lines but simply deprive the public of the advantages inherent in lower cost water transportation. We submit that, if the purposes of transportation regulation are to prevent abuses and protect the public interest, manifestly, the regulator must be accorded the powers necessary to carry out its responsibi-

lities. As previously indicated, appellants here contend that Congress clearly intended the Commission to have such powers in intermodal controversies and further urge that the public interest in the preservation of an adequate transportation system by all modes compels the reaffirmation in this proceeding of the existence of those powers in the Commission.

VI.

CONCLUSION

For the reasons heretofore stated appellants pray that the judgment of the District Court be reversed and the complaint dismissed.

Respectfully submitted,

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SUPREME COURT, U. S.

No. 804

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,
Appellants,

v.

LOUISVILLE & NASHVILLE RAILROAD CO. AND PENNSYLVANIA RAILROAD CO., ET AL.,
Appellees.

On Appeal from the United States District Court for the Western District of Kentucky

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IN THE

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No. 804

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,
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Appellees.

On Appeal from the United States District Court for the Western District of Kentucky

APPELLANTS' BRIEF

OPINION BELOW

The opinion of the District Court in *Louisville & N. R.R. et al.* v. *United States, et al.* is reported at 268 F. Supp. 71 (1967). The reports of the Interstate Commerce Commission's Division 2, and of the entire Commission on reconsideration, in *Ingot Molds, Pa. to Steelton, Ky.*, appear at 323 I.C.C. 758 (1965) and 326 I.C.C. 77 (1965), respectively.

JURISDICTION

The judgment of the lower court (A. 32-33) was entered May 15, 1967, and notice of appeal (A. 11) was

filed on July 14, 1967. Probable jurisdiction was noted by this Court on January 15, 1968, —— U.S. ——, 88 S. Ct. 782. Jurisdiction to review the decision on direct appeal is conferred upon this Court by Sections 1253 and 2101(b) of the Judicial Code, 28 U.S.C. §§ 1253 and 2101(b).

STATUTES INVOLVED

The National Transportation Policy, 49 U.S.C. preceding §§ 1, 301, 901, and 1001; Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. § 15a(3), and Sections 8(c) and 10(e) of the Administrative Procedure Act, 5 U.S.C. §§ 557(c) and 706, respectively, are set forth in the appendix hereto.

QUESTIONS PRESENTED

1. Does section 15a(3) of the Interstate Commerce Act limit the Commission's power to determine the lawfulness of a competitively reduced rate to the single test of whether such rate is above the out-of-pocket (incremental) cost of the proponent thereof?

2. Does section 15a(3) preclude the Commission from using the full cost of the low-cost mode as the floor for a lawful competitive rate of the high-cost mode in order to recognize and preserve the inherent advantage of the low-cost mode?

3. Is the Commission's decision, as found by the district court, contrary to this Court's decision in *ICC* v. *New York, N. H. & H. R.R.*, 372 U.S. 744 (hereinafter *New Haven*)?

4. Did the Commission state a rational basis and adequate findings to support—

   (a) its use of a comparison of full costs in determining which of the competing modes has the inherent cost advantage, and

(b) its use of the full costs of the low-cost mode as the floor for a lawful competitive rate of the high-cost mode?

STATEMENT

This case was brought in the court below by the rail appellees [1] to test the validity of their position respecting the power (more accurately, lack of power) of the Commission in intermodal competitive rate cases. Their position, briefly stated, is that the Commission lacks authority to hold unreasonably low any rate which returns at least the out-of-pocket (incremental) cost of the service provided by its proponent.

This proceeding originated with the suspension by the Commission of a railroad rate of $5.11 (reduced from $11.86) per gross ton on ingot molds and stools from Pittsburgh, Pa., to Steelton, Ky. The purpose of the reduced rail rate was to divert a substantial volume of that traffic which had been moving in barge-truck service [2] at $5.11 per gross ton.

At the hearing which followed suspension of the rail rate, it was shown that the rail fully-distributed cost of performing the service involved was $7.59; the barge-truck full cost was $5.19. The rail out-of-pocket cost was shown to be $4.689.

In the first report herein, 323 I.C.C. 758 (A. 35), the Commission's division 2 recognized that the barge-truck service possessed the inherent advantage of low cost, adhering "to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented." 323 I.C.C., 762-63 (A.

[1] The two railroads originally involved before the Commission were joined in the court below by 48 other large railroads which intervened.

[2] The truck portion of the movement was only 3.5 miles, i.e., between Owensboro, Ky., and Steelton.

41) Nevertheless, the division held that the reduced rail rate should be allowed to become effective because the barge-truck rate was 8 cents per gross ton below full cost, which, in effect, constituted a waiver of the right to the preservation of the inherent cost advantage of the barge-truck service. (A. 41-43) The rail rate became effective March 19, 1965.

Both parties to the proceeding sought reconsideration. The railroads requested "the elimination of a policy statement to the effect that fully distributed costs are adhered to by the Commission in determining the low-cost mode." (A. 63) The barge lines sought reversal of Division 2's report on the ground that it "is contrary to the legislative history of Section 15a(3) of the Interstate Commerce Act, and cannot be reconciled with any reasonable theory of destructive competition, as reflected in the national transportation policy." *Ibid.*

In its report on reconsideration (326 I.C.C. 77, A. 60), the entire Commission agreed with Division 2's conclusion that full costs should be compared in determining which mode of transport has the inherent cost advantage (A. 66); however, it disagreed with the division's conclusion that the barge lines had lost the right to have their inherent cost advantage preserved, because "such an advantage cannot be lost merely by the creation, accidental or otherwise, of a rate below a fully distributed cost level." (A. 69) The Commission concluded that "by reducing its [sic] rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage." It found the rate "unjust and unreasonable, and in contravention of the national transportation policy," (A. 71-72) and ordered it cancelled. (A. 80)

The railroads sued in the court below to set aside the Commission's order. The Department of Justice chose not to defend the Commission's order, but actively sided with

the railroads. These appellants, representing the regulated motor-carrier industry, intervened in support of the Commission's order,[3] to defend its power in intermodal rate cases. The lower court set aside the Commission's order on the grounds that "the Commission failed to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs," 268 F. Supp. 82 (A. 31), and "that the record here and the Commission's report supply no basic [sic] for disregarding that intent." 268 F. Supp. 83 (A. 32)

SUMMARY OF ARGUMENT

These appellants interpret the decision of the lower court as giving the railroads all that they have long sought through their various proposals to amend the rule of ratemaking in the Interstate Commerce Act, which Congress has steadfastly refused to grant them up to and including the 1958 amendment of Section 15a. By that amendment Congress did not manifest an intent to allow carriers almost complete freedom to publish rates which return little or nothing more than the out-of-pocket cost of providing the service involved. To the contrary, the pertinent legislative history makes it clear that Congress intended that the Commission should have discretion to disallow rates which return revenue sufficient only to cover, or slightly in excess of, out-of-pocket cost, when the proponent of such rates is the high-cost carrier on a fully-distributed cost basis.

In reaching its conclusion respecting the Congressional intent underlying enactment of Section 15a(3), the court below erred:

(a) in its interpretation of the pertinent committee reports;

---

[3] In addition to the intervening rail plaintiffs referred to *supra*, p. 3, n. 1, various water carrier interests intervened in support of the Commission's order.

(b) in its reliance upon the Commission and court cases cited as supporting its decision; and

(c) in its assumption that rejection of the so-called Miller-Wadsworth amendment has a bearing upon the situation involved in this proceeding, and its construction of the National Transportation Policy.

If Congress had intended to establish the strict limits on the power of the Commission in intermodal competitive ratemaking cases which the court below found it did, it seems obvious that intention would have been manifested, not by indirection, but in clear and specific legislative language.

In addition, this Court's *New Haven* decision forecloses that of the court below. And the position which the Department of Justice took below was—with respect to the salient point here involved—contrary to that which it took, and, more importantly, contrary to this Court's *New Haven* decision.

Finally, the Commission's decision does not lack a rational basis merely because the lower court disagreed with its treatment of the conflicting carrier interests before it.

ARGUMENT

Interest of Appellants

While the court below noted (A. 31) "that there [could] be situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory," it offered no example of such a situation. With deference, we submit that if the situation here involved does not evoke such power in the Commission, it is hard to imagine one which would.

Generally speaking, the nature of the railroads' plant and operations, and the wide variety of the traffic they transport, results in their having, with some exceptions,

lower out-of-pocket costs than their competitors. This, coupled with their enormous financial power, which is rapidly being concentrated in the hands of fewer and fewer railroads as a result of the rail merger movement, gathering momentum for some years and still under full throttle, makes it impossible for water and motor carriers to compete with railroads on the basis of rates which return only (or little more than) out-of-pocket costs.

What the court below has done is to embrace the railroads' theory that the Commission may not hold unreasonably low any rate which returns at least the out-of-pocket cost of providing the service involved. The impact which the forced adoption of this policy by the Commission would have upon the railroads' motor and water competitors would be disastrous. The report of the Commission furnishes a graphic illustration of the railroads' power—assuming the validity of the rail theory of intermodal competitive ratemaking—to treat their competitors like "sitting ducks" and pick off, selectively, their most valuable traffic. The Commission (A. 68) noted that "iron and steel products, which includes ingot molds, is the third most important commodity group transported in barge service, accounting for 10.81 percent of their total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of the total barge revenue. In fact, the railroads readily concede this point."[4]

The District Court Misinterpreted The Legislative History of Section 15a(3)

Bills (S. 1920 and H. R. 6141) were introduced in the 84th Congress which, among other things, proposed revi-

[4] There are many motor carriers which are authorized to transport only one (e.g. automobiles) or limited categories of commodities (e.g. iron and steel products). Even in the case of motor carriers authorized to transport "general commodities" they cannot offer significant competition in the handling of many commodities (e.g., coal) because of the railroads' inherent advantage of low cost on most such movements.

sion of the ratemaking section of Part I of the Act (§ 15a). They would have prohibited the Commission, in determining whether a rate was unreasonably low, from considering or giving effect to the low-cost status of a competitive mode, or preserving the inherent advantage thereof. This was to be accomplished by amendment of Section 15a(1) of the Interstate Commerce Act to include the "three shall nots." These "shall nots" would have prohibited the Commission, "in determining whether a rate, fare, or charge, or classification, regulation, or practice to be applied in connection therewith, results in . . . less than a reasonable minimum charge" from considering "the effect of such charge on the traffic of any other mode of transportation; or the relation of such charge to the charge of any other mode of transportation; or whether such charge is lower than necessary to meet the competition of any other mode of transportation . . . ."[5] This proposal was endorsed by a witness appearing for the Association of American Railroads.[6] These bills died in committee. Enactment of the "three shall nots" would have prevented the Commission, in this proceeding, from comparing the costs of the competing modes in order to determine which of them possessed the inherent advantage, or from finding, as it did, that the rail rate impinged upon that inherent advantage and contravened the National Transportation Policy. Ironically, the decision below limits the Commission's discretion to precisely the same extent as would have resulted from enactment of the "three shall nots."

In the 85th Congress, the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce issued a report in which it recom-

[5] TRANSPORTATION POLICY, Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, April-June, 1956, 84th Cong., 2nd Sess., p. 5. These are printed in three parts and extend through 1860 pages. H.R. 6141 is reproduced in Part 1 at pages 1-15.

[6] *Id.*, p. 548.

mended the addition to Section 15a of a new paragraph (3) to read as follows: [7]

> In a proceeding involving competition with another mode of transportation, the Commission, in determining whether a rail rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by railroad *and not by such other mode.* (Emphasis supplied)

After additional hearings before the entire Committee at which the Chairman of the Commission registered its opposition to the proposal,[8] the Committee recommended the language finally enacted, which language not only eliminated the phrase "and not by such other mode," but added the last sentence in the subsection which requires that due consideration be given to the objectives of the National Transportation Policy.[9] When section 15a(3), as cast in that form, was enacted, Congress had before it the testimony of the then Chairman of the Commission that the phrase, ultimately discarded, "and not by such other mode," was objectionable because it "would enable the railroads to contend that it is intended to give to them complete freedom, in the presence of competition from another mode of transportation, to establish rates which merely cover out-of-pocket costs" [10] and also his earlier testimony that "[f]or the purpose of ascertaining the most economical form of carriage, full costs should be the

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[7] PROBLEMS OF THE RAILROADS, Committee Print of Report of the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2nd Sess., p. 12.

[8] RATEMAKING RULE-ICC ACT, Hearings Before the Senate Committee on Interstate and Foreign Commerce, May 20-21, 1958, 85th Cong., 2nd Sess., on S. 3778 pp. 166-169.

[9] TRANSPORTATION ACT OF 1958, Report of the Senate Committee on Interstate and Foreign Commerce on S. 3778, S. Rept. No. 1647, 85th Cong., 2nd Sess., June 3, 1958, pp. 2-4.

[10] Hearings, n. 8, *supra*, p. 167.

test." [11] This testimony of the Chairman of the Commission is ignored by the lower court in its opinion.

The Cases Relied Upon By The Court Below Do Not Support Its Decision

To buttress its conclusion that Congress intended to allow railroads complete freedom to reduce their rates, so long as they recovered out-of-pocket cost, the court relies heavily on the *New Automobiles* case,[12] and other cited cases. This reliance is misplaced.

The *New Automobiles* case was an extremely comprehensive proceeding embracing "all rates, charges, rules, regulations, and practices in the United States subject to parts I and II of the Interstate Commerce Act applying to the interstate transportation of new automobiles, whether by rail, in carloads, or by truck-away, tow-bar or drive-away, hereinafter described, or by any of these modes in conjunction with water carriage." [13] The opinion therein occupies over 100 pages in the volume in which it is reported. If nothing else, the contrast between the complex issues there, and the relatively simple ones here, illustrates the impossible task which would confront the Commission in attempting to carry out its duty in deciding a wide variety of rate cases under the theory adopted by the court below.[14]

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[11] PROBLEMS OF THE RAILROADS, Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce, January-April, 1958, 85th Cong., 2nd Sess. The printed record is in four parts and contains 2355 pages. The testimony quoted was given on March 28, 1958, and is at p. 1839.

[12] New Automobiles in Interstate Commerce, 259 I.C.C. 475 (1945).

[13] *Id.*, at 477.

[14] We do not mean that Congress could not do what the lower court seems to hold it has done. But we do suggest that Congress is aware of the extremely complicated rate problems often faced by the Commission and can hardly have intended, by indirection, to have so drastically limited its power to deal with them.

New Automobiles does not support the decision of the court below. The motor carriers there—unlike the barge lines here—were not seeking to preserve an inherent low cost advantage. In fact, the Commission's report notes, *id.*, at 530, that one of the motor carrier representatives sought a rule that "in meeting highway competition the railroads should in no instance go below the fully distributed rail costs *or the truck rates.*" (Emphasis supplied) As to this contention, the Commission said, *Id.*, 539:

> Freezing the rail and the motor-carrier rates on a common level would allocate additional traffic to the motor carriers, because of their door-to-door service and other advantages. For movements exceeding 200 miles, the rate parity and the advantages of the motor carriers would spread an umbrella over them, and bring them much more of the long-haul traffic, *although for such distances they are least fit from a cost standpoint.* As shown, they already have most of the short-haul traffic. The rail costs permit the rail carriers, except for very short hauls, to meet the present highway competition at compensatory rates lower than the motor common carrier rates. (Emphasis supplied)

Without going into greater detail regarding the Commission's *New Automobiles* decision, we think it clear that it does not stand for the proposition which the lower court attributes to it, i.e., that the Commission may not ordinarily determine which transport mode has the inherent advantage of low cost on the basis of fully-distributed costs.

The lower court also stated (A. 25) that it "gain[s] support" from the decision in *Missouri Pacific R.R.* v. *United States*, 203 F. Supp. 629 (1962). But the court seems to have concentrated solely upon the outcome of *Missouri Pacific*, as distinguished from the far different circumstances there than those here. The district court there twice noted, 203 F. Supp. 632, and 634-35, that the Commission had found that "[i]nterpretation of the low

cost mode of transportation is impossible on this record, and the decision rests on other grounds," and further, the rail rates were "compensatory, and generally exceed full cost."

In *Missouri Pacific* the district court pointed out the obligation of the motor carriers which protested the railroad rates to show that the motor-carrier service was the low-cost mode, and that they had failed to do so. *Id.*, at 635. This factor, together with the cited findings of the Commission, persuaded the court that it "is the rails' inherent advantage . . . which is being asserted in the instant rates," and that "[c]ancellation of the proposed rates would hinder competition fostered by Section 15a (3) and destroy, not preserve, inherent advantage." *Ibid.*

The facts here are the opposite of those in *Missouri Pacific*. Here it is the rails' competitors which have shown that they are the low-cost mode. Here, unlike the situation in *Missouri Pacific*, the reduced rail rate doesn't even approach full cost, much less exceed it. It is thus clear that *Missouri Pacific*, properly interpreted, supports the decision of the Commission here, and not that of the court below.

The court below (A. 28) also referred to the approval expressed by the Senate Committee of this Court's language in its *Schaffer* [15] decision:

> The ability of one mode of transportation to operate with a rate lower than competing types of transportation is precisely the sort of "inherent advantage" that the congressional policy requires the Commission to recognize.

We concede that the purpose of enacting Section 15a(3) was to promote intermodal competition in transportation —if that is what the lower court means to imply. But *Schaffer* involved denial by the Commission of an applica-

[15] *Schaffer Transportation Co.* v. *United States*, 355 U.S. 83 (1957).

tion to provide motor carrier service on the ground that rail service could adequately meet the needs of the shippers supporting the application. And as this Court noted, the Commission "discounted the testimony" of the shippers because it believed that their main purpose "was the prospect of obtaining lower rates." 355 U.S., at 91. It is in this context that the cited statement in *Schaffer* must be evaluated. Certainly, neither this Court's *Schaffer* decision nor the "approval" of the language quoted therefrom by the Senate Committee lend support to the decision of the court below.

The Court Below Erred In The Inference It Drew From Rejection Of The Miller-Wadsworth Amendment And Its Construction Of The National Transportation Policy

The lower court construed the legislative history of the Transportation Act of 1940, with particular emphasis on the rejection of the so-called Miller-Wadsworth amendment, as supporting the conclusion it reached, pointing out that Congress "rejected all proposals which would have prevented carriers from offering compensatory rates which were below fully-distributed costs . . . .". (A. 30). We have no quarrel with this reading as a literal interpretation. But it does not prove the converse. Because Congress, admittedly, recognized the impracticality of requiring rates which would recover full cost on all traffic, it surely does not follow that it intended to lay down an inflexible rule that any mode of transport was free to publish rates, on any and all traffic, which recover only, or little more than, out-of-pocket cost, with the Commission powerless to exercise any restraint on the carriers' managerial discretion. Just as the first proposition would mean that many commodities would not move in commerce, or that their present movement would be significantly reduced, so the second would pose the threat of bankruptcy for the entire transport industry, or at least the smaller and financially weaker segments thereof.

The district court refers briefly [16] to some of Congressman Wolverton's remarks regarding the Miller-Wadsworth amendment. A more extensive examination fails to support the inference drawn by the district court. In his remarks on the amendment, the Congressman also said (86 Cong. Rec. 10191 (1940)):

> The bill before us provides for fair and impartial regulation of all modes of transportation so that the inherent advantages of each will be recognized and preserved. There is no need for any amendment to give each form of transportation assurance on this point.
>
> The bill, as it stands, also fully protects one type of common carrier from unfair rate-cutting competition by another having higher costs. In the light of its provisions, the Interstate Commerce Commission could not permit such unfair or destructive competitive practices. Consequently, the Wadsworth amendment would contribute nothing in the way of safeguarding a carrier from unfair rate-cutting but would create an unbearable and unjust burden upon shippers.
>
> * * * *
>
> Under the amendment Congress would prescribe a rigid rule to control the Interstate Commerce Commission's judgment concerning minimum rates. *It has long been recognized that making freight rates by statute cannot be successful. Neither can regulation by arbitrary and inflexible rate-making rules be successful. Flexibility and elasticity are as important to transportation price making as they are to price making in other industries, and rates cannot be made by formula, but must be regulated by the sound judgment of an administrative body.* (Emphasis supplied)

The proper inference to be drawn from Congressman Wolverton's remarks, we submit, is that Congress, in rejecting the Miller-Wadworth amendment, desired to avoid statutory ratemaking *of any kind*. It is, therefore, error

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[16] 268 F. Supp., at 82, including n. 5 (A. 30-31).

to ascribe to such rejection any inference that Congress intended to depart from its traditional policy of allowing the Commission a considerable degree of "[f]lexibility and elasticity" in the field of "transportation price making." Yet that is the intent which the decision of the district court imputes to the rejection of the proposed amendment.

The failure of the court below to give adequate consideration to several pertinent provisions of the National Transportation Policy was, to some extent, responsible for its erroneous conclusion respecting Congress' intent in enacting Section 15a(3). It is "fundamental that a section of a statute should not be read in isolation from the context of the whole Act," *Richards* v. *United States*, 369 U.S. 1, 11 (1962). Neither, we submit, should one provision of the National Transportation Policy be read in isolation from the balance thereof. The district court stressed the provision of the Policy requiring the Commission "to promote efficient and economical use of transportation resources and the establishment of rates which are as low as possible." (A. 19) It virtually ignored several other equally relevant provisions of the Policy, requiring the Commission to preserve the inherent advantages of each transport mode, to foster sound economic conditions in transportation and among the several carriers, and to prevent unfair or destructive competitive practices. Admittedly, some of these provisions, if their aims are pursued separately, present a conflict. The Commission cannot, as did the court below, concern itself in a case such as this with only one of the Policy's mandates. To the best of its ability, it must reconcile the otherwise conflicting provisions thereof, and act as a "coordinator of the different modes of transportation." *Eastern-Central Motor Carriers Ass'n.* v. *United States*, 321 U.S. 194, 205-206 (1944). How, we ask, may it be expected, at one and the same time, to fulfill *all* its obligations under the National Transportation Policy without the discretion—which the lower court would deny it—to determine, on

the facts of this case, that the inherent advantage of low cost rests with the barge-truck service, and that the rail rate, which returns substantially less than full cost, impairs that inherent advantage in contravention of the Policy?

The Congressional Intent Found By The District Court Would Have Been Expressed Unambiguously

It would have been easy for the Congress, if its "mandate" to the Commission in the form of the new Section 15a(3) was as restrictive as the court below finds it to be, to have expressed such intention in simple and unambiguous language. It could, for example, have enacted the "three shall nots." But it did not do so. It could have amended the law to provide that the Commission should find no rate unreasonably low which returned at least the out-of-pocket cost of the service to which it applied. But it did not do this either.

The report of the Senate Committee on Interstate and Foreign Commerce notes that the new subsection (3) of Section 15a "is designed to encourage competition in transportation by allowing each form of transportation subject to the Interstate Commerce Act full opportunity to make rates reflecting the inherent advantages each has to offer, *with such ratemaking being regulated by the Interstate Commerce Commission, however, to prevent 'unfair or destructive competitive practices' as contemplated by the declaration of national transportation policy.*" Senate Rep. No. 1647, 85th Cong., 2nd Sess., p. 3 (Emphasis supplied)

Again, we suggest that had Congress intended to write a hard and fast rule that the Commission could hold no rate violative of the cited language of the National Transportation Policy unless it failed to return at least out-of-pocket cost, it would have chosen more appropriate language than that referred to. This, we respectfully submit, points up the basic error in the decision of the court be-

low. It finds an intent by Congress to severely limit—by a mechanistic formula—the Commission's function and authority in the area of competitive ratemaking; yet it nowhere points to specific language, in either the law or committee reports, which makes this claimed intent reasonably clear.

The New Haven Decision Forecloses That of the Court Below

These appellants read this Court's *New Haven* decision as clear support for the action which the Commission took. The lower court notes, first, that this Court left open the question of which, if either, of out-of-pocket or fully distributed costs is the "appropriate method of deciding which of two competing modes has the cost advantage on a given movement."[17] It then contents itself with rather limited quotation from this Court's *New Haven* decision, stressing those portions which note that Congress did not regard a rate of one transport mode as unfair or destructive merely because its effect might be to divert traffic from a competing mode. (A. 23)

Yet the fact is that this Court's *New Haven* decision anticipated *exactly* the situation here involved, and established a guidepost which the court below ignored. To us, the "key" language of this Court's opinion, which should have governed the decision of the court below, is as follows:

> If a carrier is prohibited from establishing a reduced rate that is not detrimental to its own revenue requirements merely because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service. Nor should the selective character of such a rate reduction, made in response to a particular competitive situation, be permitted, *without more*, to furnish a basis for rejecting the rate. Section 15a(3), in

[17] A. 18, citing 372 U.S., at 760-61.

> other words, made it clear that something more than even hard competition must be shown before a particular rate can be deemed unfair or destructive. *The principal purpose of the reference to the National Transportation Policy, as we have seen, was to prevent a carrier from setting a rate which would impair or destroy the inherent advantages of a competing carrier, for example, by setting a rate, below its own fully distributed costs, which would force a competitor with a cost advantage on particular transportation to establish an unprofitable rate in order to attract traffic.* 372 U.S. at 759 (Emphasis supplied)

In this connection, it is pertinent to refer to the position of the Department of Justice before this Court in the *New Haven* case. Among other things, its brief there contains a thorough review of the legislative history of Section 15a(3).[18] Later, *Id.*, p. 40, the Department stated that the district court in *New Haven* "was correct in holding that the cancellation of these rates [which return at least the fully-distributed cost of carriage] was improper." And the Department set forth, *Id.*, 40-41, what it contended should be the standard "to justify the disallowance of a proposed rate reduction because of its impact on a competitor." The Department espoused the view that such a disallowance would be justified where the competitor (1) possesses an inherent cost advantage which (2) the proposed rate would "destroy, or at least impair." Continuing, the Department concluded:

> Such impairment occurs, we submit, when the low-cost carrier is unable to fix a rate which (a) covers its fully distributed costs and (b) affords it in [sic] a rate advantage (as against the high-cost carrier) which is no less than the cost differential (measured in terms of fully distributed costs) between the two modes.

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[18] Brief for the United States in Nos. 108, 109, 110, 125, *I.C.C. et al.* v. *N.Y., N.H. & H. R.R.*, October Term, 1962, pp. 22-39.

> Certainly, then, in ordinary circumstances, a rate which exceeds the fully distributed costs of the high-cost carrier cannot be deemed "destructive." Conceivably in some instances the low-cost mode may require for particular movements a rate significantly higher than fully distributed costs in order to offset revenue deficiencies on other freight which will not move at a fully compensatory rate; in such cases, there might be justication for maintaining a differential at levels higher than would otherwise be warranted. . . .[19]

It is thus clear, we submit, that the Department of Justice, when *New Haven* was under consideration by this Court, took a position not at all in accord with the decision of the court below in this case. Its concern in *New Haven* with limiting the Commission's discretion in cases involving intermodal rate competition was restricted to those instances in which the Commission was dealing with rates which would recover full cost. And we think it fair to say that the emphasized portion of this Court's *New Haven* opinion, quoted, *supra*, pp. 17-18, validates the standard the Department there espoused as justification for the disallowance of a proposed rate reduction. Nevertheless, despite the absence of any intervening legislation, the Department, in the court below, took a position diametrically opposed to its previous, *New Haven*, position. Without attempting to deal in detail with its brief filed below, it should suffice to quote the concluding paragraph (p. 74) of its summary of the legislative history of Section 15a(3) and the National Transportation Policy:

> In sum, the legislative histories of Section 15a(3) and the National Transportation Policy, when read

[19] It is interesting to note that the Department's position in *New Haven* would, under the circumstances specified, justify the Commission's requiring a high cost transport mode to maintain its rate at a level even higher than that necessary to reflect the full cost differential between its service and that of the low cost mode. This proceeding, of course, does not require this Court to evaluate the validity of the Department's postulate.

together, demonstrate a Congressional intent that carriers not be prevented from offering rates which exceed relevant out-of-pocket costs. They furnish no support for the Commission's order and require the conclusion that it is erroneous.

We are aware that it is not unique for the Department to take opposite positions in the district courts and this Court in cases involving ICC orders.[20] But this is the only such case, to our knowledge, in which the Department, after establishing a position, and having had it, in effect, approved by this Court, has seen fit to then take a directly contrary position in a subsequent case involving the same principle. In any event, we submit, it was right the first time, and, as already noted, this Court's *New Haven* decision forecloses that of the court below.

The Commission's Decision Has a Rational Basis

The district court (A. 17) held that the Commission's order "lacks a rational basis." But an analysis of the lower court's decision, we submit, shows that what it really meant was that it did not agree with the Commission's use of fully-distributed cost as the measurement to determine which of the competing transport modes involved possessed the inherent advantage of low cost. Perhaps the lower court believed that since the railroads had introduced voluminous testimony (A. 81-160) by several economists who espoused their views with respect to competitive ratemaking, the Commission was obliged to explain its rejection of those views in similar detail.[21] We submit that the Commission had no such obligation, and that its reasoning in support of its conclusion constitutes a rational basis therefor.

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[20] See, for example, *Schaffer, supra*, 355 U.S., at 87 (n. 4).

[21] Admittedly, the "bulk" of economic testimony, largely repetitive, was placed in the record by the railroads. But there was countervailing testimony. See that of Witness Steiner, A. 178 *et seq.*, particularly A. 203-224.

This Court has held that a regulatory agency such as the Commission is not bound to accept expert opinion evidence tendered by a proponent when the experts are in disagreement and interested, the subject is inherently uncertain, and the opinion is founded on a basic theory which the Commission could lawfully disapprove. *Dayton Power & Light Co.* v. *Public Utilities Commission*, 292 U.S. 290, 299-300 (1934). In *Market Street R. Co.* v. *Railroad Comm. of California*, 324 U.S. 548, 560 (1945), this Court said:

> Experts' judgments, however, would not bind the Commission. Their testimony would be in the nature of argument or opinion, and the weight to be given it would depend upon the Commission's estimate of the reasonableness of their conclusions and the force of their reasoning.

And in *Minneapolis & St. L. R. Co.* v. *United States*, 361 U.S. 173, the Court rejected the proposition that the Commission's findings are insufficient where it fails to make them in the terms in which an argument is advanced.

The Commission devoted a substantial portion (A. 64-72) of its report to a discussion of its reasons for disagreeing with the contentions of the railroads and their economists. And, we submit, a reading of the *whole* discussion, rather than merely that small portion cited by the court below (A. 18-19), fairly discloses the rationale underlying its choice of full, rather than out-of-pocket, cost as the proper determinant for measuring which of the competing transport modes was the low-cost carrier.

In view of the many prior pronouncements by the Commission of the principle here followed, it would have been enough if the Commission merely stated that it continued to follow its well-established policy for reasons articulated in its prior decisions, studies and reports to the Congress. See *J. H. Nowinsky Trucking Co.* v. *United States*, 196 F. Supp. 748, 751 (N.D. Wis., 1961); *Simpson* v. *United*

States, 200 F. Supp. 372, 377 (S.D. Iowa, 1961), aff'd, 369 U.S. 526; Cf. *NLRB* v. *Seven-Up Bottling Co.*, 344 U.S. 344, 349 (1953).

In stating its reasons for rejecting the argument of the railroad economists and for choosing to stay with the full-cost basis for determining which of the competing transport modes possessed the inherent advantage which the National Transportation Policy requires it to recognize and preserve, Division 2 found as follows:

> For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the Nation's transportation system is to be healthy. Thus, whenever competitive carriers of different modes assert cost advantages inherent to their respective modes, we have recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is reasonably practicable to apportion. Difficulties of apportioning constant costs do prevail. See *Grain in Multiple-Car Shipments—River Crossings to So.*, 321 I.C.C. 582, 597, reversed on other grounds in *Cincinnati, N.O. & T. P. R. Co.* v. *United States*, 220 F. Supp. 46 (S.D., Ohio 1963), appeal docketed, U.S. July 29, 1964, (No. 545). Since constant costs are not directly related to service units, they are assigned on an average statistical basis. In our opinion, however, that assignment does not detract from their worth. We adhere to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented. Stated differently, we recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced herein by respondents ignores them. We decline to so limit our ratemaking powers. (A. 40-41; footnotes omitted)

The entire Commission agreed with the findings of Division 2 which analyzed the argument of the four economists. The district court completely ignored the above

explanation, and instead quarreled with the merits of further findings of the entire Commission, which read:

> We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, does not necessarily mean that the carrier is the more efficient of the two. Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve. (A. 67-68)

These findings clearly express the Commission view that to leave the high-cost mode free to make rates on the basis of out-of-pocket (incremental) costs would fail to preserve the inherent cost advantage of the low-cost mode, since the low-cost mode would thereupon be unable to compete on a rate level which would permit it to recover its full costs. The Commission reasoned that if the lower cost mode were forced to compete with rates of the high-cost mode at the level of the latter's incremental costs, the ability of the low-cost mode to continue in full vigor as a part of our national transportation system would be impaired. If this were to happen, the Commission would not be able to coordinate its regulation of the competing modes so as to attain the objectives of the National Transportation Policy. These are rational reasons which are adequate under the requirements of the Administrative Pro-

cedure Act to support the Commission's order. This is particularly true in view of the railroads' complete failure to carry their burden of demonstrating that the Commission's long-established policy failed to properly measure the "inherent advantage" of low cost.

That a court may disagree with the Commission's analysis of complex accounting and economic issues, as did the lower court, is not enough to justify setting aside its order on the ground that it lacks a rational basis. As this Court said in *Chicago & N. W. R. Co.* v. *Atchinson, T. & S. F. Ry.*, 387 U.S. 326, 356 (1967):

> Its [Commission's] factual findings and treatment of accounting problems concerned matters relating entirely to the special and complex peculiarities of the railroad industry. Our previous description of the Commission's disposition of these matters is sufficient to show that its conclusions had reasoned foundation and were within the area of its expert judgment. (Citations omitted)

CONCLUSION

The order of the Commission here involved did not lack a rational basis, and did not exceed its statutory authority to determine which of the competitive transport modes before it possessed the inherent advantage of low cost. Neither the legislative history of Section 15a(3) nor the National Transportation Policy supports the action of the lower court in setting aside the Commission's order. This Court's *New Haven* decision anticipated the precise situation with which the Commission was here faced, and foreordained a conclusion opposite to that reached by the court below.

For the reasons stated, it is submitted that the judgment of the court below should be reversed and the case remanded with instructions to dismiss the complaint.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Peter T. Beardsley, one of the attorneys for appellants herein, and a member of the bar of the Supreme Court of the United States, hereby certify that, on the 8th day of March, 1968, I served copies of the foregoing document on the several parties hereto, in duly-addressed envelopes, with postage prepaid, as follows:

1. On Honorable Erwin R. Griswold, The Solicitor General, Department of Justice, Washington, D. C. 20530, and on Donald F. Turner, John H. D. Wigger, and Robert Johnson, Esqs., Department of Justice, Washington, D. C. 20530.

2. On Robert W. Ginnane, Esq., General Counsel, and Leonard S. Goodman, Esq., Assistant General Counsel, Interstate Commerce Commission, Washington, D. C. 20423.

3. On Harry C. Ames, Jr., Esq., 529 Transportation Building, Washington, D. C. 20006, J. Raymond Clark, Esq., 743 Investment Building, Washington, D. C. 20036, and A. Alvis Layne, Pennsylvania Building, Washington, D. C. 20004, counsel for appellant barge lines.

4. On Carl Helmetag, Jr., Esq., Six Penn Center Plaza, Philadelphia, Pa. 19103, Elbert R. Leigh, Esq., 908 West Broadway, Louisville, Ky. 40201, and Harry J. Breithaupt, Jr., Esq., 929 Transportation Building, Washington, D. C. 20006, counsel for appellees.

PETER T. BEARDSLEY

APPENDIX

NATIONAL TRANSPORTATION POLICY

[September 18, 1940.] [49 U. S. C., *preceding* §§ 1, 301, 901, and 1001.] It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficie t service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

RULE OF RATE MAKING

Sec. 15a [February 28, 1920; amended June 16, 1933, September 18, 1940, August 12, 1958.] [49 U.S.C. § 15a.]

* * * *

(3) In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a

particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

ADMINISTRATIVE PROCEDURE ACT

Sec. 8 [June 11, 1946, amended September 6, 1966] [5 U.S.C. § 557]

* * * *

(c) Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions—

(1) proposed findings and conclusions; or

(2) exceptions to the decisions or recommended decisions of subordinate employees or to tentative agency decisions; and

(3) supporting reasons for the exceptions or proposed findings or conclusions.

The record shall show the ruling on each finding, conclusion, or exception presented. All decisions, including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of—

(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and

(B) the appropriate rule, order, sanction, relief, or denial thereof.

* * * *

Sec. 10 [June 11, 1946, amended September 6, 1966] [5 U.S.C. § 706] To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicabil-

ity of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

SUPREME COURT, U. S.

MAR 11 1968

JOHN F. DAVIS, CLERK

No. 808

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

THE AMERICAN WATERWAYS OPERATORS, INC., *Appellant,*

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and PENNSYLVANIA RAILROAD COMPANY, ET AL., *Appellees.*

On Appeal From the United States District Court for the Western District of Kentucky at Louisville

BRIEF FOR THE AMERICAN WATERWAYS OPERATORS, INC.

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March 1968

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BRIEF FOR THE AMERICAN WATERWAYS OPERATORS, INC.

OPINIONS BELOW

The opinion of the District Court is reported at 268 F.Supp. 71. The report of the Interstate Commerce Commission is reported at 326 I.C.C. 77, and the preliminary report of a division of the Commission is reported at 323 I.C.C. 758. These reports appear in

full in the joint appendix filed in this Court. The appendix page references in this brief are to that appendix.

JURISDICTION

The judgment of the District Court was entered on May 15, 1967, and notice of this appeal was filed in the District Court on July 12, 1967. The time for docketing this appeal in this Court was subsequently extended to and including November 9, 1967, by successive orders of the District Court and this Court. Probable jurisdiction was noted on January 15, 1968.

STATUTE INVOLVED

Section 15a(3) of the Interstate Commerce Act (49 U.S.C. § 15a(3)), as amended by the Transportation Act of 1958, 72 Stat. 572, and the statement of National Transportation Policy (49 U.S.C. preceding 1, 301, 901, and 1001), 54 Stat. 899. As so amended, section 15a(3) provides that minimum rates "shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act." That policy states that the Act shall be "so administered as to recognize and preserve the inherent advantages of each" mode of transportation subject to the Act.

QUESTION PRESENTED

Our jurisdictional statement states the question as follows:

> When the Commission finds that a rail rate has been reduced on traffic "of far more consequence to the barges than to the railroads" to a point where "all of the traffic would move by rail" and thus threatens the ability of the barges "not only

to compete, but to exist" (App. 57, 53, 57),[1] and further finds by a comparison of fully distributed costs that the barges are the low-cost carrier; may the railroads justify the reduction on the ground that the reduced rate exceeds their out-of-pocket costs.

Since the District Court's acceptance of the railroads' out-of-pocket cost justification required rejection of the Commission's fully distributed cost comparison, the question may be more briefly stated as follows:

Did the District Court err in rejecting the use of fully distributed costs to determine the low-cost carrier.

STATEMENT

The American Waterways Operators, Inc. is a national association of shallow draft water carriers that intervened in the Court below to support the Commission's order. For a full statement of the proceedings below and the relevant facts, we rely upon the Statement in the brief of the Interstate Commerce Commission. Our Statement is confined to the following decisive facts found by the Commission:

1. The railroad appellees cut their rate for carrying ingot molds from Pittsburgh, Pennsylvania, to Steelton, Kentucky, from $11.86 to $5.11 per ton.

2. The $5.11 rate was low enough to divert to the railroads substantially all of this ingot mold traffic from the bargeline then carrying it.[2]

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[1] The corresponding references in the Joint Appendix are J.A. 68, J.A. 64, and J.A. 68.

[2] The movement is one in which trucks also participate, but it is discussed hereafter as a barge movement because most of the revenue goes to the bargeline.

3. This class of traffic "is of far more consequence to the barges than to the railroads" (J.A. 68).

4. The fully distributed cost of rendering this transportation service was $7.594 for the railroads and $5.196 for the barge-truck movement.

5. The out-of-pocket cost of this railroad service ($4.689) was "lower than the barge-motor lines' variable costs. Therefore, the railroads can wage the rate battle as long or longer than the bargelines" (J.A. 71).

The District Court set aside none of these findings. Its rejection of the Commission's decision seems to rest upon its conclusion that because "compensatory rates should normally be allowed" (J.A. 31-32), "relevant out-of-pocket costs" (J.A. 31) should be compared to find the low-cost carrier. We argue that this was an erroneous conclusion.

SUMMARY OF ARGUMENT

We assume that the 1958 amendment to section 15a(3) of the Commerce Act prevents the Commission from rejecting a rail rate reduction merely because it threatens to exclude a competing mode of transportation from carrying the traffic affected by the reduction. We also assume that Congress intended to permit the Commission to reject a rail rate reduction which threatens to exclude a competing mode from carrying traffic if the competing mode can carry the traffic at a lower cost. We do not argue these propositions because we believe they were established by this Court's *New Haven* decision.[3]

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[3] *Interstate Commerce Commission* v. *New York, N.H. & H.R.R. Co.*, 372 U.S. 744 (1963).

Our argument also assumes that the rail out-of-pocket cost figure of $4.869 is a permissible cost allocation for the purpose of determining whether the $5.11 ingot mold rate is a profitable rail rate and that the fully distributed cost figures of $7.594 and $5.196 are equally permissible cost allocations for the purpose of distributing the total costs of a railroad and a bargeline, respectively, among their total traffic movements. For the limited purpose of this argument, it need only be understood that the difference between the railroad fully distributed and out-of-pocket cost figures is substantially attributable to the exclusion from the out-of-pocket figure of very large constant costs peculiar to the ownership and operation of a railroad.[4]

There are, of course, a number of different kinds of inherent advantages of bargelines when compared with railroads and they may be measured in different ways. The main thrust of this argument is that one of these inherent advantages derives from the bargelines' use of public waterways and that the scope of this particular inherent advantage may only be measured by comparing the full costs of these two modes of transportation. For this reason, out-of-pocket cost comparisons will not prevent destruction of bargeline competition by railroads. We shall first show that out-of-pocket cost comparisons will not prevent destructive

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[4] The $7.594 fully distributed cost figure includes all variable and all constant costs while the $4.869 out-of-pocket figure includes all variable and some constant costs. The term out-of-pocket is therefore somewhat misleading in suggesting that only the additional costs incurred to move the additional traffic in question are included. However, the technically correct description, "long-range out-of-pocket costs," is no clearer than the District Court's "relevant out-of-pocket costs" label and we shall use the term "out-of-pocket" to mean costs less than full costs.

rail rates, then show that a fully distributed cost comparison will reflect the advantage inherent in the bargelines' use of public waterways.

1. Railroads are able to charge substantially different prices for transportation service with similar costs because they carry thousands of different commodities under widely varying competitive conditions. For example, the ratio of railroad rates to out-of-pocket costs for individual commodities varies from 110 for carrying coal to 249 for carrying machinery parts. The ratio for commodity groups ranges from 107 for Animals and Products to 152 for Manufacturers and Miscellaneous (J.A. 144). The same ratio ($5.11 divided by $4.869) for the ingot mold rate in issue here is 105. The end result of such value of service rather than cost of service pricing is that 65 percent of a railroad's traffic moves at rates below the traffic's pro rata share of the full cost of running a railroad (J.A. 141, 155). This long-established discriminatory method of pricing by which many shippers contribute less than their pro rata share of a railroad's total freight revenue and some contribute more has been permitted by the Commerce Act.

Bargelines, on the other hand, are incapable of such discriminatory pricing. There is relatively little difference between barge fully distributed costs and out-of-pocket costs because bargelines "do not furnish or maintain their own roadway plant" and "their total expenses vary closely with the volume of traffic handled" (J.A. 157). Bargelines handle a comparatively limited number of commodities and their total volumes do not approach those of railroads. Unlike railroads, they can not earn profits from rates that do not approximate full costs. Bargeline rates must be

based on a narrow margin of profit because they carry only low-rated traffic, subject to competition from other modes of transportation. Moreover, bargelines can not afford to engage in rate wars with railroads because they move nothing that railroads can not move while railroads carry huge volumes of traffic between points not reached by waterways.

The out-of-pocket cost standard adopted by the District Court would, if adopted by the Commission, permit the railroads to preempt traffic essential for barge-line survival, regardless of the relative efficiency of barges and rails in moving the traffic. Barges are often lower cost carriers than railroads because barges move on publicly owned waterways and railroad cars move on privately owned tracks. A full cost comparison will reflect this inherent advantage—an out-of-pocket cost comparison will not, as the Commission found in this case.

2. The Commission has usually compared fully distributed costs to find the more efficient mode and the sole purpose of such a cost comparison is to determine whether there is a public advantage in protecting one mode from another's destructive competition. In recognition of the railroads' normal use of rates that do not vary consistently with variations in cost, the Commission will not disallow a railroad's reduction of a rate below its full costs upon proof that it was aimed at the elimination of intermodal competition. Unless the competitor threatened with elimination shows also that it is more efficient than railroads in moving the traffic in question, the Commission grants no protection against such a rail rate cut. There is no antitrust remedy and, if the Commission does not act, the competing mode must simply suffer the loss of this traffic.

This approach to the problem of preserving intermodal competition gives the railroads an extraordinary advantage that an application of antitrust principles denies to other industries.

The Court below set aside the Commission order here because it thought out-of-pocket costs were the only relevant costs; the $5.11 rate exceeded the rail out-of-pocket costs and such compensatory rates should normally be allowed. The purpose of the Commission's cost comparison, however, was to identify the lower cost mode and not to find whether the $5.11 rate was compensatory for the railroads. The District Court's reasoning thus ignored the inherent advantage problem.

The District Court criticized the Commission's full cost comparison, but offered no analysis to show that an out-of-pocket cost comparison would disclose which mode had an inherent cost advantage and was therefore more efficient. Most courts are reluctant to make such relative efficiency judgments when an expert agency, intimately familiar with the performance and problems of the business units involved, has been authorized by Congress to make such a judgment. In *New Haven,* the railroads successfully argued that this Court "should not attempt to advise the Commission how an inherent low cost advantage should be determined. . . ." (p. 9, Brief for Appellees, *New Haven, et al.*) and this Court did not do so. There is, therefore, no judicial precedent that determines what makes one mode of transportation more efficient than another.

A barge movement would appear to be a less costly method of transporting commodities suited to barge handling between two points on a river than a rail movement and the only cost comparison that will

tell whether this apparent low-cost advantage is real is a comparison of fully distributed costs. Such a comparison is needed to reflect the cost advantage resulting from the barges' use of publicly owned and maintained waterways as against the railroads' use of privately maintained rails, rights of way, switching yards, and terminals.

Whether an inherent advantage from the use of public waterways is an unfair advantage is not a judgment for the Commission or the courts to make. The decision to permit and encourage this transportation use of public waterways has been made by Congress and may be revoked only by Congress. The Commission is not authorized to decide that the public advantages of the low-cost competition offered by barges to other forms of transportation should not be preserved even if it should believe that such advantages did not equal the public cost of maintaining such waterways.

3. The railroads are free to urge Congress to destroy the advantages of bargelines inherent in public ownership and maintenance of waterways, but the railroads have not been authorized to do the job themselves by an unrestricted use of their own extraordinary power to destroy barge competition by rate reductions. The scope of railroad power is only partially revealed by the facts noted by the Commission in its discussion in this case of destructive barge-rail rate wars (J.A. 68). The available published data assembled at page 16 of this brief shows that sixty percent of the revenue of all Class A bargelines reporting to the Commission are received from transportation of five classes of commodities. The bargeline revenue from this traffic is less than ten percent of the revenues received from these classes of commodities by their eastern and south-

ern railroad competitors. The conclusion of the Court below that the railroads may increase their existing domination of this traffic, so long as they keep their rate reductions above their out-of-pocket costs, is plainly wrong, and the decision should be reversed.

ARGUMENT

I. The Out-of-Pocket Cost Standard Proclaimed by the District Court Would Not Prevent Destruction of More Efficient Barge Competition by Rail Rate Cuts

Neither the District Court nor the railroads considered the problem of how to appraise the public advantages inherent in bargeline transportation. The railroads urged that any rail rate in excess of incremental costs [5] should be allowed because it is a compensatory rate. Both the District Court and the railroads reached this erroneous conclusion by ignoring obvious fundamental differences between barge and rail costs. Railroads have widely variable costs per unit of transportation service, depending on the extent to which they utilize their extraordinarily large fixed plant. Bargelines have relatively constant low costs per unit of transportation service because they have little fixed plant. A railroad's unit costs go down with increased use of its large fixed plant while a bargeline's unit costs remain relatively constant with increased use of existing waterways.

The legislative history of the Congressional policy to recognize and preserve the inherent advantages of each mode of transportation shows that protection of such low-cost water transportation "from out-of-pocket competitive rate-making" by railroads is the heart of

[5] The railroad economists used "incremental costs" interchangeably with "out-of-pocket costs" (J.A. 139).

this policy.[6] Out-of-pocket cost rate-making was the means by which railroads drove boats from the rivers in the past. It is still an obvious means of destroying bargeline competition and thereby destroying the advantages of using public waterways for low-cost transportation that Congress created and intended to preserve.[7]

In this case the ratio of the reduced ingot mold rate to out-of-pocket costs was only 105. The extraordinary nature of this reduction is apparent when this 105 ratio is compared with the average ratio of 152 for Manufactures and Miscellaneous, the class of traffic embracing ingot molds. When aimed at the elimination of a competitor, such discriminatory pricing adversely affects competition in the same manner as discriminatory pricing of industrial products. In antitrust cases, this Court has condemned such predatory price-cutting without determining whether the cut price returns a profit on out-of-pocket costs. *Cf. United States* v. *National Dairy Products Corp.*, 372 U.S. 29, 34 (1963), and *Moore* v. *Mead's Fine Bread Co.*, 348 U.S. 115, 117-18 (1954).

The Commission makes a cost analysis of predatory price cuts only because the Commission applies a more lenient standard of liability than the antitrust laws provide. The Commission construes its mandate to preserve intermodal competition as warranting protection against such anti-competitive pricing only when it finds that the injured mode is the lower cost mode.

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[6] McGehee, *The Inherent Advantages of Carrier Modes Under the National Transportation Policy*, 34 ICC Prac. J. 722, 725 (1967).

[7] Nelson, *Rate-Making in Transportation—Congressional Intent*, 1960 Duke L.J. 221, 228-29.

Yet the railroads would frustrate even this limited protection of intermodal competition by sanctioning any predatory rate so long as it yields a railroad profit.

II. The Commission's Full Cost Standard Fairly Determines Inherent Cost Advantages

The total expenses of a railroad include the cost of owning and maintaining extensive tracks, rights of way, switching and terminal facilities. The total expenses of a bargeline do not include any comparable expenses because Congress permits bargelines to use waterways built and maintained by public funds. Railroad economists call this a bargeline subsidy; but, however labeled, it provides low-cost transportation that carries public benefits in the form of low rates.

As the Commission said, in rejecting an argument that part of the public cost of maintaining waterways should be attributed to bargelines in making intermodal cost comparisons:[8]

> Inherent advantages must be determined on the basis of costs of operation which the different modes actually bear and not on the basis of hypothetical costs which would have been incurred if the historic policy of the Congress were different. *Grain In Multiple-Car Shipments—River Crossings to South,* 321 I.C.C. 582, 592 (1963); reversed on other grounds, 229 F.Supp. 572, and remanded to the Commission after vacation of District Court's order by this Court at 379 U.S. 642.

The Commission's full cost comparison reflected this advantage and any cost comparison limited to the costs that vary with the volume of traffic handled does not.

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[8] See also the discussion of this decision in Nathanson, *Intermodal Competition and the Minimum Rate Power,* 58 Nw. U. L. Rev. 583, 610 (1963).

Terminal, maintenance, and ownership of right of way costs are borne by railroads and not by bargelines whether they carry ingot molds or not.[9] While some of these costs may vary to some extent with the volume of traffic carried, they are all among the constant costs included in the fully distributed cost comparison made by the Commission. Under the definition of "relevant out-of-pocket costs" relied upon to show that the all-rail rate is compensatory, a substantial part of these constant costs was excluded.[10]

The issue for decision below was not whether compensatory rates should usually be allowed, but whether

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[9] Studies made for the Office of the Under Secretary of Transportation, Department of Commerce, and published as *Cost Accounting System for Ground Modes of Common Transportation Carriers*, September 1966, while illustrating the difficulty of determining by any accounting formula the precise cost of particular movements, point up the existence of substantial constant costs for railroads that do not exist for barges. For example, Volume III: Barge Manual, Section II, Chapter I, Introduction, notes that:

> Because most terminal operations are carried on by shippers and receivers, barge lines generally do not have sizable terminal operations and thus the assignment of terminal costs to specific shipments—one of the most elusive problems in much transportation cost-finding—is generally not a major problem area in barge line cost-finding.

Volume I: Railroad Manual, lists at page 34, Service Costs for Rail, Highway and Barge Transportation. The item "Maintenance and ownership of way, by geographically located facilities for originating and terminating traffic" appears only in the Rail column. Railroads, by virtue of their extensive holding of real property, also bear a real estate tax burden that barglines do not.

[10] Rail Form A, the formula used in this case to determine the railroads' out-of-pocket costs, excludes 20 percent of the railroads' full operating costs, rents, and taxes other than income taxes; and also excludes a four percent return on 50 percent of the railroads' fixed property.

the Commission had made a proper cost comparison to determine whether bargelines or railroads had lower costs. The Commission's cost comparison was not made for the purpose of determining whether the decisions of either the railroads or bargelines to move ingot molds between the specified points at the $5.11 rate was economically sound. The sole purpose of the comparison was to find out whether the bargelines had an inherent cost advantage that would justify suspension of a rail reduction which threatened to exclude bargelines from this movement. The Commission's full cost comparison reflected the advantages inherent in the barges' use of publicly owned waterways. The railroads' out-of-pocket cost computation showed at most that the $5.11 rate was a compensatory rail rate. In this context, the District Court's rejection of the Commission's fully distributed cost comparison because "compensatory costs should normally be allowed" ignored the regulatory problem of the Commission.

In Docket No. 34013, *Rules to Govern the Assembling and Presenting of Cost Evidence,* 321 I.C.C. 238, the railroads are attacking a full cost comparison as measuring the relative efficiency of barges and rails because such a comparison reflects the advantages inherent in bargeline use of public waterways. In this proceeding now pending before the Commission, the railroads' argument that the public cost of maintaining these waterways should be regarded as a bargeline disadvantage has been rejected by the Hearing Examiner in favor of continued use of a comparison of the full costs actually incurred by the carriers involved

to determine the low cost mode.[11] The suggestion of the Court below that out-of-pocket costs should be compared to find the low cost carrier must be rejected since no one claims that such a comparison will reflect the low cost advantage resulting from the barges' use of public waterways. The District Court's suggestion that it was unfair to include railroad passenger deficits in full cost comparison is immaterial here (J.A. 20). Even with passenger deficits excluded, the railroads fully distributed costs for the ingot mold movement in issue substantially exceed the fully distributed costs of the bargeline movement.[12]

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[11] In his report of October 10, 1966, the Hearing Examiner rejected the railroads' contention, saying:

> There is no doubt that public costs give rise to handicaps and, if such costs are disregarded, they distort the true economic picture with respect to both relative and total use of national resources in the production of particular transportation. Nevertheless, when expenditures are expressly authorized for certain public projects which may directly or indirectly bestow special benefits on one mode to the disadvantage of another competing mode, it must be assumed that Congress was cognizant of the consequences of its actions and intended the results flowing therefrom . . . . It is not open to the regulatory agency to redetermine the reasonableness of the level of such costs, nor to remove what may be conceived as handicaps, and thus substitute its judgment for that of the legislature. As concluded by the Commission, the public-cost question is peculiarly within the competence of the Congress to determine and lies far beyond the authority delegated to the Commission (pp. 90-91).

The Commission has not yet acted upon exceptions to this report filed by the railroads and others.

[12] In Docket No. 34013, *supra*, the Examiner has also recommended the elimination of passenger deficits from full cost comparisons, but this has not eliminated railroad objections to his report.

III. Commission Intervention Is Needed to Preserve Intermodal Competition for Bargeline Traffic

The most important classes of traffic for Class A bargelines reporting to the Commission, in terms of gross revenue, during the year 1964 (the latest for which these statistics have been published), were Field Crops (011), Iron Ore (101), Bituminous Coal & Lignite (112), Products of Petroleum Refining (291), and Steel Works and Rolling Mill Products (331). These five commodity classes accounted for nearly 60 percent of Class A bargeline revenue. The following table shows the comparative gross revenues from these commodity classes during that year received by these bargelines and by their principal railroad competitors, stated in millions of dollars.

	Commodity Class	Class A Bargelines	Eastern Railroads	Southern Railroads
011	Field Crops	22	96	80
101	Iron Ore	11	114	8
112	Bituminous Coal & Lignite	39	426	175
291	Products of Petroleum Refining	8	45	31
331	Steel Works & Rolling Mill Products	23	259	51
	Totals for Five Classes	103	740	345
	Totals for All Classes	165[13]	2,730[14]	1,353[14]

[13] Figures in this column, except Totals for Five Classes, are for Class A carriers, Table 5, Part 5: Carriers by Water, I.C.C. Transport Statistics in the United States, year ended December 31, 1964. Class A water carriers are those having average annual operating revenues exceeding $500,000.

[14] Parallel figures in the column for eastern railroads are from pages 5-8, and in the column for southern railroads are from pages 13-16, I.C.C. Freight Commodity Statistics of Class I Railroads in the United States for the year ended December 31, 1964.

The table shows that Class A bargelines received less than ten percent of the total revenue of the limited classes of commodities that bargelines must carry to survive. It also shows that the total bargeline revenues from these five classes of traffic is less than three percent of total rail revenues. No argument is needed to show that by selective cuts on these commodities between points served by bargelines the railroads may destroy the business of the bargelines without any substantial decrease in railroad net revenues. As this record shows, they may achieve this result by lowering their rates below the bargelines' full costs while at the same time maintaining them above rail out-of-pocket costs.

This table also shows that the Commission's full cost comparison in rate suspension cases involving rail-barge competition has not excluded and can not exclude railroads from competing for barge traffic. A full cost comparison does permit protection of barge traffic from rail rate cuts below barge costs when the barge movement is shown to be more efficient than the rail movement by virtue of lower costs attributable to bargeline use of publicly owned and maintained waterways.

If the facts found by the Commission here, to wit, lower full costs of barges and threatened destruction of the barges as competitors for the traffic, do not justify suspension of a rail rate cut below both the rails' and the barges' full costs, it is difficult to visualize facts that would justify suspension of a rail rate to preserve intermodal competition. When the railroads chose to appeal the Commission's decision on the ground that it had erred in relying upon a comparison of rail and barge full costs, they deliberately suggested a rule of

law which would let them destroy lower cost carriers rather than compete with them. The District Court's decision would permit such a result and is therefore contrary to the Congressionally declared policy to preserve the public advantages of intermodal competition.

We respectfully submit that the District Court's decision should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1967

INTERSTATE COMMERCE COMMISSION, APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR THE INTERSTATE COMMERCE COMMISSION

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In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 809

INTERSTATE COMMERCE COMMISSION, APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR THE INTERSTATE COMMERCE COMMISSION

OPINIONS BELOW

The opinion of the district court (A. 12–32) is reported at 268 F. Supp. 71. The opinion of the entire Commission (A. 60–72) is reported at 326 I.C.C. 77; an earlier opinion of the Commission, Division 2 (A. 35–59) is reported at 323 I.C.C. 758.

JURISDICTION

The judgment of the three-judge district court (A. 32–33) was entered on May 15, 1967, and the Commission filed its notice of appeal on July 13, 1967. The appeal was docketed in this Court on November 9, 1967, and jurisdiction was noted on January 15, 1968.

The jurisdiction of this Court to review the judgment of the district court on direct appeal is con-

ferred by 28 U.S.C. 1253 and 2101(b). *American Trucking Associations, Inc.* v. *Atchison, Topeka and Santa Fe Ry. Co.*, 387 U.S. 397 (1967); *American Trucking Associations, Inc.* v. *United States*, 364 U.S. 1 (1960).

STATUTE INVOLVED

Section 15a of the Interstate Commerce Act, 49 U.S.C. 15a, provides in its entirety:

> (1) When used in this section the term "rates" means rates, fares, and charges, and all classifications, regulations, and practices relating thereto.
>
> (2) In the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenue sufficient to enable the carriers, under honest, economical, and efficient management to provide such service.
>
> (3) In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to

the objectives of the national transportation policy declared in this Act.

The National Transportation Policy, 49 U.S.C. preceding §§ 1, 301, 901 and 1001, provides:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

QUESTIONS PRESENTED

Appellee railroads proposed a substantially reduced rate to capture bargeline traffic. The reduced rate was filed at precisely the level of the existing barge-truck

rate. The reduced rate exceeded the railroads' out-of-pocket costs, but was less than their fully-distributed costs; the rate was also less than the fully-distributed costs of the bargelines. The Commission ordered the reduced rate canceled on the grounds that it impinged upon the ability of the bargelines to assert and maintain their inherent cost advantage. The district court reversed the Commission's order. The questions presented are:

1. Whether, in view of Section 15a(3) of the Interstate Commerce Act and the National Transportation Policy, the Commission was precluded from ordering the rail rate canceled simply because the rate exceeded the railroads' out-of-pocket costs of transporting the traffic.

2. Whether the Commission's reliance on a comparison of the fully-distributed costs of each competing mode of transportation in order to recognize and preserve the inherent advantages of the low-cost mode was legally permissible and justified in the circumstances of the present case.

STATEMENT

For nearly 10 years the commodity ingot molds, which are iron forms in which molten steel is cast, moved almost exclusively by bargeline and truck from Pittsburgh, Pennsylvania, to Steelton, Kentucky (A. 36–37, 61). The Pennsylvania Railroad Company (now the Pennsylvania New York Central Transportation Company) and the Louisville and Nashville Railroad Company proposed to reduce their rate of $11.86 per ton on the ingot molds and stools moving between

these points by more than one-half (to $5.11) to capture this traffic. The Commission suspended the proposed reduction on petition of the bargelines (A. 36), and both the railroads and the bargelines presented evidence at the ensuing hearings. The rate became effective by operation of law when the Commission failed to conclude the proceeding within the seven-month suspension period authorized by the statute.[1]

The Commission accepted each party's computation of its own costs at the hearings. The railroads computed their "long-term out-of-pocket costs" at $4.69 per ton (A. 63). These costs were computed as follows: a witness for the L. & N. presented evidence of its costs of operating in the Southern Region, reduced by five percent to reflect the lesser costs of switching and loss and damage claims on ingot mold traffic (Exhibits 7, 8); a witness for the Pennsylvania also testified that its costs would approximate that carrier's Eastern District costs after minor adjustment (Exhibits 11, 12). The two computations were then combined for a composite "long-term out-of-pocket" cost of both railroads (Exhibit 9).[2] The railroads further computed their full cost of moving this traffic, *i.e.*, their "fully-distributed costs," of $7.59

[1] Section 15(7) of the Interstate Commerce Act, 49 U.S.C. 15(7).

[2] The long-term out-of-pocket costs were computed under a Commission-sponsored formula which generally holds that 80 percent of rail operating expenses, rents and taxes are out-of-pocket and will vary with the traffic. To this is added a return element of 4 percent on a portion of the investment (all the equipment and 50 percent of the road property), and this element was apportioned to each ton of the present traffic.

using the same Eastern District and Southern Region averages.[3]

The water carriers, based on the costs of the Mississippi Valley Barge Line Company, computed their fully-distributed costs to be $5.19.[4] This figure was just above their out-of-pocket costs.[5] Since the bargelines had no right-of-way costs, none were included in the foregoing computation.[6]

The railroads then presented the testimony of four economists:

1. Professor William J. Baumol led off by stating his "fundamental conclusion" that in setting price floors only the incremental costs of the carriers proposing the rate are relevant.[7] He would defer to the "profit motive" of the railroads (A. 90). He expressly rejected the cost of the low cost carrier as a standard

[3] A. 63, 199.

[4] The full cost figure included barge full costs of $3.40, a barge-to-truck transfer charge of 95 cents, and a for-hire truck charge of 84 cents (A. 61, 63, 166, 173).

[5] The formula for the computation of bargeline costs, Barge Form C (Exhibit 24 in the present record), states in its Explanatory Statement, "In the absence of studies showing the actual portion which out-of-pocket expenses are of total bargeline expenses, the operating expenses are treated in this formula in effect as though they were 100 percent out-of-pocket." And see discussion at A. 201–203, 229–230, and page 46, note 80, *infra*.

[6] The computation of bargeline costs in Exhibit 24 of record includes no user charges relating to waterways or ports (*e.g.*, p. 19). Since the water carriers here had no right-of-way costs, a witness for the water carriers stated that such costs need not be "recovered from these particular rates" (A. 209).

[7] Exhibit 37, A. 83–84.

for determining price floors of competing modes since "there is wide variation in the extent to which they made use of public facilities and thereby impose very real and significant costs on society . . ." (A. 89). Although other modes might be exempt from paying for their rights-of-way, he would not give them the benefit of their exemption in a cost comparison with the railroads. In his view, the public costs of owning and maintaining waterways must be added to barge costs in any comparison with rail costs (A. 236). He flatly disagreed with the remarks of Commissioner Freas [8] during the hearings on the 1958 Act (A. 233–34). He added (A. 90–91):

> So long as its own costs are such as to permit a profitable expansion of its traffic by means of a reduction in price, a carrier should be encouraged to undertake it regardless of the costs of its competitors.[9]

2. Professor James M. Buchanan's testimony [10] paralleled that of Prof. Baumol; counsel stipulated that Prof. Buchanan's answers on cross-examination would be the same as those of Prof. Baumol.[11] Prof. Bu-

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[8] Cited by this Court in its opinion in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 755 (1963) (hereinafter the *New Haven* case).

[9] The witness objected to all cost comparisons in cases involving competition between modes (A. 84, 229–30, 236). He further objected to full cost comparisons because they would not guarantee the same profitability as out-of-pocket rates on selected traffic (A. 92, 94, 97).

[10] Exhibit 39, A. 117–129.

[11] A. 246; and see A. 119.

chanan contended that the motor carriers' cost of using the highways is to a large extent borne by the whole community, and noted that bargelines do not pay user charges for their waterways; but like Prof. Baumol he would merely increase those carriers' costs to offset any such advantages (A. 119–20). He rejected the thought that rail freight rates should be based on the costs of the low cost carrier as "backward reasoning" and "perverted logic" (A. 128).

3. Professor Richard B. Heflebower testified in a similar vein,[12] and the parties stipulated that he would respond to questions like Prof. Baumol (A. 247). He stressed what he termed the "excess capacity" of the railroads occasioned by the need to maintain heavy roadbeds for heavy trains or due to "an earlier optimistic forecast of traffic volume" (A. 132). For "the optimal use of resources in the railroad industry", railroads must charge at a long-term out-of-pocket level on some traffic (A. 134). In his view, whichever mode has the lower incremental cost[13] would be the "more efficient" (*ibid.*). However, such costs of other modes must add in "the *social* incremental costs of the publicly-owned facilities—including, for example, highways, waterways, and airports" (A. 135) (Emphasis his).

4. Finally, Dr. Ford K. Edwards[14] under the stipulation would also have testified like Dr. Baumol.[15] Dr.

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[12] Exhibit 40, A. 129–136.

[13] The railroad witnesses equated the phrase "incremental costs" to the phrase "out-of-pocket costs" as used by the Commission (A. 85).

[14] Exhibit 38, A. 137–160.

[15] A. 246, and see A. 153.

Edwards added in his direct testimony that the only pertinent consideration in this case was whether the proposed rate made the maximum contribution to railroad profit (A. 138–141). He testified that railroad pricing has no direct relation to the costs of carriage (A. 143–145). In his opinion, the presence of water competition renders out-of-pocket ratemaking by the railroads of even greater moment, for the railroads must *overcome* certain cost advantages of other modes. He explained:

> In the briefest terms, it is noted that the rails supply their own roadway plant and facilities all of which would continue irrespective of the instant traffic. In contrast, government supplies the corresponding rights of way for water carriers. The fixed costs for waterway improvements are borne by the government. No taxes are assessed water carriers for the use of waterways. Water carrier costs approach 100 percent variability.[16]

Rather than protect these cost advantages of the water carriers, the witness recommended incremental pricing to ensure the railroads' "right to participate in the haul of the traffic in issue" (A. 152).

Mr. Steiner, the economic witness for the water carriers,[17] would protect the water carriers' cost advantages. In his opinion full costs is a "realistic economic framework within which to determine low cost carriage, [and] the most-economic allocation of national resources directly purchased and used by each of the competing modes of transportation . . .

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[16] A. 151–152; and see A. 157.

[17] Exhibit 32, A. 178–189.

particularly . . . where the modes of transportation have significantly different cost structures" (A. 184–185). He further questioned the economic soundness of the railroads' diverting the movement from another mode where the shipper would not benefit from a lower rate and there would be no increase in the total volume of traffic (A. 204).

The essential questions presented to the Commission by the railroads were, (1) whether the proposed rate was "lawful from the cost standpoint if it exceeds the proponent carrier's own incremental costs," and (2) whether comparing costs to determine which mode has a cost advantage would be "a futile exercise, uncalled for by the law, and destructive of sound economic principles."[18]

The division held that it would adhere to the use of full costs "as the standard for determining the inherent advantage of low cost in the situation presented," after citing *Grain in Multiple Car Shipments—River Crossings to South,* 321 I.C.C. 582 (1963), which along with the second report in that case (325 I.C.C. 752) is hereinafter referred to as the *Grain* case. It then held that the water carriers' inherent cost advantage was lost, when the bargelines priced their service a few cents below their own full costs (A. 41–42); and it accordingly approved the railroads' reduced rate.

Both parties petitioned for reconsideration of the division's report. The railroads repeated their earlier arguments that the proposed rate was lawful from a

[18] Brief of the Respondent Railroads, filed with the Commission on June 10, 1964, page 28.

cost standpoint when it exceeded the proponent carrier's out-of-pocket costs, and alleged that any comparison of costs with another mode would be "almost certain of failure" and "self-defeating." One reason cited by the railroads for their objection to "unrealistic cost comparisons" was that "one of the compared modes may have a large part of its facilities provided by the Government, either without cost to it or at charges which are far less than compensatory to the Government. The other [mode] provides all of its equipment and facilities without Government assistance." [19]

The entire Commission in a report and order of November 9, 1965, agreed with the division's cost findings (A. 63).[20] It further agreed with the division's reading of the earlier *Grain* case that fully-distributed costs had been the applicable standard in measuring inherent cost advantages (A. 65–66). It stated that no showing had been made that such standard was inappropriate or inadequate (A. 67); nor had the railroads shown they were the more efficient competitors (A. 67–68). The Commission referred to other proceedings involving rail-barge competition in which it had used a full-cost comparison. It stated that "a radical departure from the fully-distributed cost norm as urged by the respondents would not be justified on

[19] Petition of the Respondent Railroads for Reconsideration and Modification of the Report of Division 2, filed with the Commission on March 19, 1965, page 8.

[20] The division had also stated that the record did not show the costs of the Mississippi Valley Barge Company to be representative of all barge protestants (A. 39); the entire Commission reversed this particular finding and accepted Mississippi's costs as typical for purposes of the present case (A. 63).

the limited record here before us * * *'' (A. 70). The Commission reversed the division's approval of the reduced rate, finding that the cost advantage of barge-lines, established in many proceedings, cannot be lost by the accidental creation of a rate below the barges' full costs (A. 68–69). Hence, the Commission ordered the rate canceled (A. 80) as infringing upon "the ability of the barge-truck mode competitively to assert its inherent cost advantage" (A. 71). Three members of the Commission dissented (A. 72–80).

The district court reversed the Commission in an opinion and judgment of May 15, 1967 (A. 12–33). The court held that the Commission had not stated a rational basis for relying on a comparison of the full costs of the two competing modes (A. 18), and that in any event the order was contrary to the statute (A. 25). On this latter ground the court stated that Congress intended that competing carriers should normally be free to offer rates that exceed their out-of-pocket costs (A. 31).

SUMMARY OF THE ARGUMENT

1. In section 15a(3) Congress has stated that in permitting rate reductions by one mode in competition with another the Commission must not hold up the rate of the proponent merely to protect the competitor's traffic but must give due consideration to the objectives of the National Transportation Policy. The Policy in turn requires the Commission to recognize and preserve the inherent advantages of each mode, including inherent cost advantages. Such a policy is not

susceptible of fulfillment in terms of a rule of law; it requires that consideration be given to the particular circumstances of individual carriers or groups of carriers of competing modes. The lower court's opinion deprives the Commission of the discretionary authority to fashion a standard or standards for comparing costs of different modes, and substitutes the out-of-pockets costs of the proponent carrier as the only lawful standard except in extraordinary cases. The ruling undermines the on-going administrative task of recognizing and preserving inherent advantages. The court's ruling is further unrelated to preserving any specific advantages; it is propounded as a rule of law without discussion of its practical consequences in terms of administering the transportation policy. Finally, the ruling is contrary to the opinion of this Court in the *New Haven* case, which expressly holds that the task of defining and preserving cost advantages is an administrative, and not a judicial, one.

2. The district court improperly sustains the rail rate reduction solely according to a standard of what rate is the most profitable to the proponent mode of transportation. It substitutes a standard of pure economics for the statutory policy that inherent cost advantages first be recognized and then be preserved. It ignores the statutory framework of fair and impartial regulation of the competition between different modes of transportation, and improperly holds that the Act and the Policy permit a carrier to establish rates that are compensatory from its own revenue

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standpoint without regard to the inherent cost advantages of competing modes.

3. From the earliest period of the Interstate Commerce Act, Congress has evinced a purpose to prevent out-of-pocket pricing by the railroads that had as its purpose the destruction of competing modes. First in section 4 of the Act, then in the Motor Carrier Act of 1935, and finally in section 15a(3) and the National Transportation Policy, Congress sought to protect the low-cost advantages of competing modes of transportation from out-of-pocket rates. One such advantage of the competing water carriers repeatedly recognized, and apparent on the face of the present record, is the absence of right-of-way costs. Congress on advice of the Commission never enacted any cost measure that should govern all competitive cases as a matter of law; nevertheless, it made clear that any measure should recognize and preserve the competitors' cost advantages, such as the absence of right-of-way costs.

4. The full cost standard here employed by the Commission does recognize the long established cost advantages inherent in the operations of the inland water carriers of this country, such as the absence of right-of-way costs in their cost computations. This advantage had been described in detail in the *Grain* case, cited by both the division and the entire Commission, and had in fact been recognized on this record by the railroad witnesses. The witnesses only sought to avoid the necessary consequence of this recognition under the statute, *i.e.*, the "preservation" of such inherent advantages. The Commission on the basis of its precedents and the opinion of this Court in *New Haven*

properly refused to permit the railroads to avoid the cost comparison altogether or to make the cost comparison in a manner that would ignore the admittedly inherent cost advantages of the bargelines. Its decision to employ a full cost standard was lawful on the record before it and was supported by a plainly rational basis.

ARGUMENT

I. THE DECISION BELOW INTERFERES WITH THE DISCRETIONARY AUTHORITY OF THE COMMISSION RECOGNIZED BY THIS COURT IN THE NEW HAVEN CASE TO PRESERVE INHERENT COST ADVANTAGES OF COMPETING MODES OF TRANSPORTATION

The district court engrafts upon the statute a uniform measure of the inherent cost advantage as between two competing modes of transportation. Its rule of law withdraws the administrative discretion to measure inherent cost advantages.[21] The lower court holds that the Commission's order is "not in accordance with law," since it allegedly "failed to take account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, *i.e.*, above relevant out-of-pocket costs" (A. 31; 268 F. Supp. at 82). Congress has allegedly expressed "a clear intent that reduced compensatory rates

[21] It is true that the lower court held out the possibility of another standard in unspecified "situations" (A. 31; 268 F. Supp. at 82). As the Solicitor General has stated in the Memorandum filed in this Court, the rule of law laid down by the lower court "prohibits the Commission, except in extraordinary situations, from using fully distributed costs as the criterion for determining inherent advantage between competing modes" (p. 4).

should normally be allowed" (A. 31–32; 268 F. Supp. at 83).

The decision below leaves no room for the Commission to respond to the facts of a given case. We later show that the lower court erred in its reading of the legislative intent, that Congress in fact favored a fully-distributed cost standard,[22] if it favored any standard at all, and that it made a conscious choice to adopt no standard as a matter of law. Here we note the lower court improperly adopts a rule of law where the statute intends a role for the exercise of administrative discretion.

The statute prescribes no formula to determine or measure an inherent cost advantage. As this Court recognized in *New Haven,* the question is one of "utility" in "comparing the costs of two or more modes of transportation" (372 U.S. at 760, note 13). Hence, the proper measure of the cost advantage is an administrative question rather than a question of law. As this Court added in *New Haven,* "It is not for us to make this determination at this stage, or to decide in advance precisely how either carrier's inherent advantages should be measured or protected" (at 760). All such questions "should be left for initial resolution to the Commission's informed judgment" (at 761).

In the *New Haven* case, the Department of Justice stated the position in its separate brief to this Court that under section 15a(3) and the National Transportation Policy, the Commission may establish differen-

[22] Similarily, this Court approved fully-distributed costs as one of the legally permissible standards in *New Haven,* discussed at pp. 47–48, *infra.*

tials "to enable the low-cost carrier to recover its fully distributed costs for the service in question." In its view, "a proposed rate will destroy, or at least impair, that cost advantage . . . when the low-cost carrier is unable to fix a rate which . . . covers its fully distributed costs . . ." [23] The Department's considered solution in the *New Haven* case, reached after a carefully detailed discussion of the many facets of intermodal competition, was that an impairment of an inherent cost advantage occurs, "when the low-cost carrier is unable to fix a rate which (a) covers its fully distributed costs and (b) affords it a rate advantage (as against the high-cost carrier) which is no less than the cost differential (measured in terms of fully distributed costs) between the two modes" [24] In terms of the present facts, the Department then would have required the railroads to price their present service at no lower than $7.51, or $2.40 (the difference between the full costs of the two modes) *higher* than the present barge-truck rate.[25]

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[23] Brief for the United States in Nos. 108 *et al.*, Oct. Term 1962 (herein New Haven Brief), at 21, 40–41. In their "Corrected Brief," filed in the district court in this case, the Department claimed that the New Haven Brief only "recommended, in passing, a manner by which this protection might be accomplished."

[24] New Haven Brief, at p. 15, repeated at 40–41.

[25] In stark contrast to its New Haven Brief, the Department's Antitrust Division filed a brief in the district court in the present case urging that the determination of inherent advantages should be left to the "judgment of the marketplace, as is normally the case in a free enterprise system," and that a comparison of cost and service advantages is "not a relevant element of the rate proceedings." They espoused the railroads' position that such mode should be permitted to "achieve maximum returns." Brief of the United States in the district court, pp. 26, 32.

The Commission adopted no rigid differential in the present case, and hence its standard favored the railroads more than did the Department's standard in *New Haven*. What is most important, however, is that the decision below forecloses any further administrative refinement of the standard. The district court overlooked the Commission's basic function under the National Transportation Policy, under which the Commission became, "not merely the regulator, but to some extent the coordinator of different modes of transportation." With the passage of the Transportation Act of 1940, 54 Stat. 899, the Commission was charged with seeing that the various modes "are coordinated in accordance with the national transportation policy . . . [which] was designed to eliminate destructive competition not only within each form but also between or among the different forms of carriage." *Eastern-Central Motor Carriers Assn.* v. *United States*, 321 U.S. 194, 205–206 (1944). The decision below improperly replaces the administrative function with a rule of law.

II. THE DISTRICT COURT IMPROPERLY AUTHORIZES A RATE REDUCTION SOLELY ACCORDING TO THE STANDARD OF WHAT RATE IS THE MOST PROFITABLE TO THE PROPONENT MODE

The district court used an out-of-pocket standard only to remove "a restriction on competition" and to enable carriers to "be free to offer rates which are compensatory."[26] The decision below does not otherwise further our understanding of what "inherent advantages" the National Transportation Policy is de-

[26] A. 30–31; 268 F. Supp. at 82.

signed to protect. The decision does not rest on any analysis of water or rail transportation service, and does not consider any inherent element of their respective services that gives one mode a cost advantage over the other. Its interpretation of the statute rests entirely on the assumption that "inherent advantages" *means* the ability of one mode of transportation to add to its own profit by competing with another mode.

The railroads identified no other inherent cost advantage that would be reflected in the proposed rates. They premised their case solely on the fact that basing their rates on out-of-pocket costs permitted them to maximize their own profit. They argued they were the more "efficient" mode of transportation under the transportation policy. The Commission disagreed; the ability to make more money while avoiding an out-of-pocket loss does not show superior efficiency (A. 67–68).

The railroads in this connection oftentimes referred to their alleged "'excess capacity,"[27] which occasioned their using out-of-pocket rates. Such excess by itself would seem to indicate that the railroads were inherently inefficient, rather than more efficient, in any comparison with the bargelines, and the Commission summarily rejected their claim of superior efficiency.

The witnesses appearing for the railroads could not agree among themselves as to whether they were urging a formula that made the most efficient use of society's resources,[28] or only the most "optimal use of

[27] Exh. 38, p. 13, A. 146–47; Exh. 39, pp. 14, 15, A. 126; Exh. 40, pp. 4–6, A. 131–33.

[28] *E.g.* Exh. 37, pp. 25–26, A. 98; Exh. 39, pp. 5, 7, A. 119–20, 121.

resources in the railroad industry."[29] To the extent they argued the latter, of course, they advocated what the district court adopted, a rule premised on what is profitable to the proponent of the rate. To the extent they addressed themselves to society's resources, their argument merely avoided the cost advantage enjoyed by the bargelines. An argument regarding the best use of society's resources is more pertinent to consideration by the Congress of the question whether expenditures for waterways should be made. Since the expenditures have been made, and since "society's resources" include the fully-developed waterways, the rail economists never explain how shifting the traffic away from these waterways to the railroads is the most efficient use of all available resources.

The district court states that Congress intended the Commission to adhere to the standard it had established in the *New Automobiles* case,[30] which in its view involved "essentially" a "comparison . . . of the two modes' out-of-pocket costs."[31] However, as this Court set forth in *New Haven,* the "theme," the "particular passage in the *New Automobiles* decision which the [Senate] Committee endorsed," was a passage condemning the division of traffic merely to protect competing modes; the thrust of *New Automobiles* is en-

[29] *E.g.* Exh. 40, p. 8, A. 134; and see Exh. 37, Att. p. 9, A. 415.

[30] *New Automobiles in Interstate Commerce*, 259 I.C.C. 475 (1945).

[31] A. 29; 268 F. Supp. at 81.

tirely unrelated to the determination of comparative cost advantages.[32]

The district court states that in its view "the chief thrust" of the 1958 amendment to section 15a(3) was "to encourage competitive ratemaking." But its support for this undisputed conclusion also lays emphasis on the "inherent advantages" of each mode, without mention of out-of-pocket pricing.[33]

Section 15a(3) on its face prescribes a framework for administrative regulation of intermodal competition. As this Court stated in *New Haven*, the section relates "to the role of the Commission in its task of overseeing competition among different modes of transportation" (372 U.S. at 746). It relates to this role through its specific reference back to the National Transportation Policy (at 758). The "principal reason" for the reference back to the Policy in section 15a(3) was "to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes" (*ibid.*). Thus, the Commission's task does not end with a finding that under proposed rates that compete with other modes the railroads will maximize their profit.

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[32] See 372 U.S. at 756–57. To be sure the Commission in *New Automobiles* compared costs. But the only issue presented for decision was created by the motor carrier position that "the railroads should in no instance go below the fully distributed rail costs or the truck rates * * * to save the revenues of all forms of transportation from further depletion, and to prevent the extinction of the motor common carriers" (259 I.C.C. at 530).

[33] A. 28; 268 F. Supp. at 81.

In *New Haven*, this Court specifically rejected the theory that the task of preserving inherent advantages required only a decision regarding how one mode would make greater profit. It specifically noted that the Commission might employ some standard other than fully-distributed or out-of-pocket costs, since "the utility of the concepts . . . may be limited" to a *different* area, "the area in which they have traditionally been employed—that of determining the reasonableness of a rate from the standpoint of a carrier's own revenue requirements" (at 760, note 13). This Court stated in *New Haven* that once "a carrier shows a proposed rate to be just and reasonable from the standpoint of its own revenue requirements," the proceeding does not end; rather, "it is for a protesting carrier who relies on a claim of inherent cost advantage to bear the burden of persuading the Commission of the existence of that advantage" (at 760, note 12).

Similarly in *Eastern-Central Motor Carrier Assn.* v. *United States*, 321 U.S. 194 (1944), this Court flatly rejected the argument accepted by the district court here that considerations of competitive necessity (or one mode's self-inerest) must as a matter of law be given controlling weight by the Commission. Under the statutory policy, the choice of a predominant factor would be "for the Commission to make," and whether in any case one mode's self-interest must control is "doubtful" (*Id.* at 210–211).

Without any factual premise for the standard employed, and with a measure that fulfills only the criterion of assuring the railroads greater profit, the lower court awards the relief that years of railroad effort before Congress failed to achieve. This Court in *New Haven* detailed the battle that raged before Congress in

the Fifties and that culminated in the Transportation Act of 1958, 72 Stat. 568. Congress rejected the comparable effort of the railroads, there embodied in the "three-shall-nots", to open up rail-water competition to any rail rate that favored the railroad (see 372 U.S. at 753–58). Congress enacted legislation that contained, (1) a renewed admonition to the Commission not to hold rail rates up *merely* to make certain that water carriers shared in the traffic, and (2) an equally strong admonition that the Commission should protect the "inherent advantages" of water transportation from being impaired or destroyed by rail rate reductions. The lower court's rule of law departs from the legislation in adopting a standard that relates to the enhancement of railroad profit as the touchstone of the transportation policy.

III. THE LEGISLATIVE HISTORY OF SECTION 15A AND THE NATIONAL TRANSPORTATION POLICY SHOWS THAT CONGRESS INTENDED A COMPARISON OF RAIL AND WATER CARRIER COSTS, SUCH AS FULLY-DISTRIBUTED COSTS, THAT WOULD PROTECT KNOWN INHERENT COST ADVANTAGES OF WATER TRANSPORTATION

Before discussing why the Commission continued in this proceeding to compare the fully-distributed costs of the competing modes,[34] it may be well to set forth the legislative history of section 15a(3) and the National Transportation Policy. With this as background, we will then discuss in our last section the findings of the Commission as they fulfill the Congressional objective.

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[34] Other proceedings in which the Commission used this test following this Court's decision in *New Haven* are described at pages 48–49, *infra*.

Before 1887, the railroads with successive rate cuts succeeded in driving the water carriers from the inland waterways and greatly weakened the intercoastal carriers.[35] Just before the First World War, the railroads further succeeded in driving all independent boats from the through lake-and-rail transportation, thereby occasioning further legislation greatly restricting railroad control of water carriers.[36] As a consequence, for over 80 years Congress has imposed restrictions on the filing of rates by railroads if such rates threaten the survival of water carriers. Our review of this struggle is limited to a consideration of its effect on the development of the ratemaking standards of the Interstate Commerce Act.

1. *Prior to 1935.* In this period the significant water-rail controversies centered over section 4 of the Act, and the extent to which the railroads might charge more for a shorter haul than for the longer haul that competed with water carriers. The original Section 4 prohibited a greater charge for the shorter haul than for the longer haul unless the Commission specifically authorized a departure from the general rule.[37] In the Transportation Act of 1920, 41 Stat. 480, Congress amended Section 4 to its present wording, to

[35] See, *e.g.*, concurring opinion of Commissioner Eastman in *Petroleum Products from New Orleans, La., Group*, 194 I.C.C. 31, 44–45 (1933).

[36] The Panama Canal Act of 1912, 37 Stat. 566, 49 U.S.C. § 5(14), prohibited all rail control of water lines operated through the Canal and allowed control of other lines to continue only upon findings and an order of the Commission. An application for such an order was denied in *Lake Line Applications Under Panama Canal Act*, 33 I.C.C. 699 (1915).

[37] Act to Regulate Commerce, 1887, section 4, 24 Stat. 380.

prohibit "the establishment of any charge to or from the more distant point that is not reasonably compensatory for the service performed." [38]

On its face, the 1920 Act required more than a showing of a compensatory rate to meet the new requirements of Section 4.[39] The rate, even though compensatory to the carrier proposing it, must have a reasonable purpose and effect. In the first case to arise under the 1920 Act involving Section 4, the Commission construed the phrase "reasonably compensatory" as a mandate to pursue "a less liberal policy in dealing with departures from the long-and-short-haul rule"; the phrase implied that the proposed rate must,

> (1) cover and more than cover the extra or additional expenses incurred in handling the traffic to which it applies; (2) be no lower than necessary to meet existing competition; (3) not

[38] In addition, Congress stated the policy in section 500 of the 1920 Act "to foster and preserve in full vigor both rail and water transportation" (41 Stat. 499). In the Mann-Elkins Act of 1910, 36 Stat. 547, Congress earlier added a provision to section 4 designed, as this Court stated in *Skinner & Eddy Corp.* v. *United States*, 249 U.S. 557, 567 (1919), "to prevent the railroads from killing water competition by making excessively low rates." In an era before Congress delegated authority to the Commission to fix minimum rates, the 1910 amendment penalized a railroad that succeeded in eliminating water competition; it provided that such railroad "shall not be permitted to increase such rates unless after hearing by the Commission it shall be found that such proposed increase rests upon changed conditions other than the elimination of water competition."

[39] Prior to 1920, the cost standard under Section 4 was whether the proposed rates exceeded out-of-pocket costs. *E.g.*, see *Reopening Fourth Section Application*, 40 I.C.C. 35, 40 (1916).

> be so low as to threaten the extinction of legitimate competition by water carriers; and (4) not impose an undue burden on other traffic or jeopardize the appropriate return on the value of carrier property generally . . .

Transcontinental Cases of 1922, 74 I.C.C. 48, 71 (1922). This formulation of the standards applicable to a "reasonably compensatory" rate has been a consistent and continuous policy,[40] sustained by three-judge courts,[41] and ratified by Congress in 1935.[42]

From 1920 to 1940, Congress enacted no further ratemaking standard to govern cases involving water and rail competition. Section 15a throughout this period was limited to considerations affecting the reasonableness of the return to the carriers and of the

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[40] See *Export and Import Rates*, 169 I.C.C. 13, 53 (1930); *Newsprint Paper From Tenn. and Ala. to Baton Rouge, La.*, 315 I.C.C. 117, 122 (1961); *Steel Bars, Lemont, Ill., to Iowa, Kans., Mo., Minn. & Nebr.*, 319 I.C.C. 292, 305 (1963). The Commission extends to section 4 cases the ruling of this Court in *New Haven* that rates exceeding the proponent's full costs are reasonable and cannot be disapproved on account of their effect on a competing modes' traffic or revenues. *E.g.*, *Steel Bars* case, *supra*.

[41] *Igert* v. *United States*, 211 F. Supp. 42 (N.D. Ala. 1962); *A. L. Mechling Barge Lines, Inc.* v. *United States*, 209 F. Supp. 744, 749 (N.D. Ill. 1962), rev'd on other grounds, 376 U.S. 375; *Dixie Carriers* v. *United States*, 143 F. Supp. 844, 853 note 16 (S.D. Tex. 1956).

[42] Bills passed the House in both the 74th and 75th Congresses to abolish the long-and-short haul clause of Section 4, and one was reported favorably by the Senate Committee on Interstate Commerce, on the grounds that, "It is seen by this interpretation in *Transcontinental Cases of 1922*, the Commission has in fact legislated upon the subject * * *." See S. Rep. 1768, 75th Cong., 3d Sess., p. 7. The bill was never enacted, since the Senate refused to act. For Senator Wheeler's role in blocking the repeal of the section, see 84 Cong. Rec. 5874, 5949.

rates to the shipping public. Congress relied primarily upon the Commission's consistent administration of section 4 to ensure the survival of water competition.

2. *Motor Carrier Act of 1935.* Congress adopted a different approach to the question of the proper scope of rate competition between railroads and motor carriers. The Motor Carrier Act included a more specific ratemaking rule than in section 4. In section 216(i), 49 Stat. 558, the Commission was required to give due consideration, among other things, "to the *inherent advantages* of transportation by such carriers [and] to the effect of rates upon the movement of traffic by such carriers." (Emphasis added).

Section 216(i), as introduced, referred to the "circumstances and conditions peculiar to transportation by such carriers." As Commissioner Eastman explained, this language was added to meet the "fear expressed on the part of the motor carriers that the Commission in its regulation of motor vehicles would not give consideration to conditions which are peculiar to motor vehicles and that it would be guided by the railroad conditions in the regulation of motor vehicles." [43]

Commissioner Eastman explained before the Senate Committee that the railroads had in recent years

[43] Hearings on H.R. 5262 and H.R. 6016 before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess., p. 35 (1935). Commissioner Eastman added before the Senate Committee that this language was added to allay fears that the Commission would regulate other modes "along railroad lines" or require them "to charge the same rates as the railroads charged." Hearings on S. 1629 before the Senate Committee on Inerstate Commerce, 74th Cong., 1st Sess., p. 68 (1935).

begun to cut their rates to meet motor and water competition, and such other modes had become "greatly exercised by this tendency upon the part of the railroads, and they depend upon regulation to control it." Both modes had "protested to the Commission against reductions in railroad rates and asked that they be stopped." However, "the Commission, in dealing with those situations, is handicapped by the fact that they have control only over railroad rates, and in such circumstances the natural tendency is to resolve doubts in favor of the railroads." [44]

A representative of the National Industrial Traffic League, an organization composed of a wide range of the shipping public, opposed the general reference to circumstances and conditions. While favoring regulation of motor carriers by a "slight majority" of their members, the League had many members who feared they would be "arbitrarily deprived of the natural benefits inherent in motor transportation." [45] The witness attached to his testimony a computation of the total estimated operating costs of a motor vehicle, including a return on the investment in the truck and trailer, and contrasted this cost with the existing rail freight rate structure.[46]

A later witness representing the National Cooperative Milk Producers Federation was more specific in opposing the regulation of the rates of contract motor

[44] Senate hearings, at 85.

[45] *Id.* at 271. And see testimony of the American Trucking Association's representative, at 355.

[46] *Id.* at 286-87.

carriers. He feared that the bill "may be used to compel the contract carrier to fix his rates on the same basis as the competing railroad rates." He explained (at 515):

> In the fixing of railroad rates among other things which are considered is the valuation of the railroad properties and the question of a fair return on the invested capital. It is a well-known fact that many of the roads are highly overcapitalized, have gigantic bond issues, and heavy operating charges which must be considered in fixing railroad rates. None of these things are applicable to the contract trucker. He is only interested in obtaining for his services what he considers to be their fair value.

The League's representative suggested that the rate-making section should be amended by adding, "But the Commission in the exercise of its powers shall not prescribe any rates which will unduly advantage any form of transportation and thus take from it, its natural advantage." He further suggested that the transportation policy be amended to state "that highway transportation shall be fully protected in its natural advantages."[47]

The Senate Committee reported the bill with the reference to the "inherent advantages" of motor transportation. Senator Wheeler explained that "it makes clear the policy of Congress * * * to preserve the natural advantages of such transportation * * *

[47] *Id.* at 280.

[and] that the peculiar features of transportation by truck and by bus should be taken into consideration at all times by the Interstate Commerce Commission." [48] Similarily, the Committee changed the ratemaking section to refer to "inherent advantages" in order to "require the Commission to fix truck rates on a basis that, so far as possible, reflects the costs and advantages of the motor service." [49] This purpose of the phrase received a new impetus in the Transportation Act of 1940, 54 Stat. 899, when for the first time it applied to all modes of transportation.

3. *Transportation Act of 1940.* Commissioner Eastman explained before the Senate committee hearing the bills to codify and revise the Interstate Commerce Act, that the reference to "inherent advantages" in the newly proposed National Transportation Policy would require the Commission to regulate water rates on the basis of water conditions. He noted that in the past the motor carriers had not relied on this same requirement in the Motor Carrier Act, since they could rely on their service advantages over the railroads and thereby compete effectively with the railroads.[50]

A number of witnesses opposed any regulation of the water carriers, fearing that such regulation would result in increased water and rail rates.[51] Their

[48] 79 Cong. Rec. 5650.

[49] *Id.* at 5656.

[50] Hearings on S. 1310, 2016, 1869, 2009, before the Senate Committee on Interstate Commerce, 76th Cong., 1st Sess., p. 823 (1939).

[51] *E.g.*, Herman A. Bayless, counsel for the Mississippi River System Carriers' Association, *id.* at 296; and see 529, 673.

continued references to the "cheap transportation" provided by the water carriers brought forth the remark from Senator Reed that "the only thing that is cheap about it is occasioned by the fact that the Public Treasury pays the big end of the expense * * *." [52] The Senator distinguished the three forms of domestic surface transportation in this manner: [53]

> There are three main types of transportation. One of them, the railroad, maintains its own rights-of-way. Another type is the motor-carrier group, that uses the public highways. There is a difference of opinion whether the contribution made by the motor carriers to the upkeep of highways is too much or too little, but at least it is a substantial contribution through licenses, tonnage taxes, gasoline taxes, and so forth. The third type is the inland waterways, where boats operate on a right-of-way that is furnished to them entirely without cost.

A witness representing shippers that used water transportation similarly stated, "Water transportation has only one advantage over rail transportation. It is inherently cheaper." [54] Senator Minton added, "The whole justification of a subsidy to the water carriers is the hope and expectation that the public will benefit by a better rate." [55]

The only specific suggestion presented to the Congress to protect this inherent cost advantage of the water carriers was one that would have required the Commission to make a cost comparison of the compet-

[52] *Id.*, 367.
[53] *Id.*, 523.
[54] *Id.*, 537.
[55] *Id.*, 672.

ing modes in each case on a full-cost basis.[56] When Senator Hill asked Commissioner Eastman to appraise this suggestion, the Commissioner replied that a full-cost standard "might * * * operate to the disadvantage rather than to the advantage of the water lines" in cases where the distance by water may be three times what it is by rail. He added, "as I said to the House committee, that we will go further and further in that direction," and that he opposed "any such rigid rule in the law at the present time." [57]

The statement to the House committee referred to by the Commissioner was on a bill that, among other things, would have provided that in fixing minimum rates, "the Commission shall give due consideration to the undesirability" of allowing any carrier to establish rates below "full cost * * * where such rate * * * is maintained to meet competition." [58] Commissioner Eastman responded in a letter of March 20, 1939,[59]

> The Commission fully appreciates the dangers of basing competitive rates on "out-of-pocket" costs under conditions of widespread competition, and is quite ready to believe that some such cost standard as H.R. 2531 proposes may prove, subject to reasonable limitations, to be necessary. * * * We do not believe, however, that there has yet been sufficient experience in fixing minimum rates for the purpose of pre-

[56] *Id.*, 528.

[57] *Id.*, 824.

[58] H.R. 2531, 76th Cong., 1st Sess., sec. 41.

[59] Letter from the Chairman of the Legislative Committee, Interstate Commerce Commission, to the Chairman of the Committee on Interstate and Foreign Commerce, House Committee Print, 76th Cong., 1st Sess., p. 7 (1939).

> venting destructive competition between rival types of carriers to justify Congress in laying down any specific standard for such rates. For the present we believe it to be wiser to permit the Commission to be guided in this respect by the general ratemaking rules * * * and by the general declaration of policy * * *.

Both the House and the Senate adopted the substance of the section 41 of H.R. 2531,[60] but the conference committee omitted it on the grounds it would as a matter of law "compel an increase of rates on a large part of the freight now carried by ships, highway, and rails." The conference report added, "Legitimate regulation must look to the protection of the economic advantage of each type of carrier against destructive competition of the other * * *. The other provisions of this bill afford ample protection for the preservation of the inherent advantages of water transportation." [61] Representative Lea, one of the conferees, had earlier explained that the bill "provides for the protection of the inherent advantages of water transportation as contrasted with other means of transportation. In fixing rates the water carrier is assured the advantages of the cheaper rate at which he can transport property." [62]

As this Court has stated, the purpose of Congress in 1940 was "to protect the water carrier's natural

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[60] The provision adopted by both the House and Senate authorized the Commission to permit reduced rates "so long as such rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all other elements entering into the cost." S. 2009, 76th Cong., 3d Sess.

[61] H. Rep. 2016, 76th Cong., 3d Sess., pp. 81–82 (1940).

[62] 84 Cong. Rec. 9862.

advantages." *Interstate Commerce Commission* v. *Mechling,* 330 U.S. 567, 576 (1947). Congress had specific cost advantages in mind. For example, Senator Ellender asked Senator Wheeler, "What is the interpretation of the Senator of the phrase 'inherent advantages of each'?" Senator Wheeler replied:[63]

> When the bill speaks of inherent advantages of the shipping interests, it refers to carriers which can transport at a cheaper rate because they can ship by water, by way of canals and the ocean, so they have natural advantages, and they do not have the expense of the upkeep of the rights-of-way, as railroads do.

Following the conference report, many legislators supported the Miller-Wadsworth amendment, which would have prevented *all railroad rates* from being reduced below rail full costs as a matter of law.[64] Senator Wolverton, one of the conferees, spoke against the amendment, stating that such a harsh rule of law was unnecessary. In his view,[65]

> the bill, as it stands, also fully protects one type of common carrier from unfair rate-cutting competition by another having higher costs. In the light of its provisions, the Interstate Com-

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[63] *Id.* at 6127, cited by this Court in the *Mechling* case, *supra*, 330 U.S. at 575, note 8.

[64] The amendment provided, "In order that the public at large may enjoy the benefit and economy afforded by each type of transportation, the Commission shall permit each type of carrier or carriers to reduce rates so long as such rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all other elements entering into the cost to the carrier or carriers for the service rendered." 84 Cong. Rec. 6074.

[65] *Id.* at 10191.

> merce Commission could not permit such unfair or destructive competitive practices. Consequently, the Wadsworth amendment would contribute nothing in the way of safeguarding a carrier from unfair rate-cutting but would create an unbearable and unjust burden upon shippers [by requiring rates that are now below full costs to be raised].

He added that Congress should not adopt "a rigid rule":[66]

> Under the amendment Congress would prescribe a rigid rule to control the Interstate Commerce Commission's judgment concerning minimum rates. It has long been recognized that making freight rates by statute cannot be successful. Neither can regulation by arbitrary and inflexible ratemaking rules be successful. Flexibility and elasticity are as important to transportation pricemaking as they are to pricemaking in other industries, and rates cannot be made by formula, but must be regulated by the sound judgment of an administrative body.

The second conference report thereupon omitted the amendment, repeating the identical language it had earlier used in rejecting a full cost rule of law;[67] and Congress approved that approach.

Senator Wheeler had expressed strong disapproval of out-of-pocket pricing as between competing modes of transportation.[68] He had also stated as early as the hearings, "There could not be anything more specific" than the reference to recognizing and preserving the

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[66] *Ibid.*; and see remarks of Congressman Hinshaw, at 9966.
[67] H. Rep. 2832, 76th Cong., 3d Sess., pp. 87–88 (1940).
[68] 84 Cong. Rec. 5949.

inherent advantages of each mode of transportation.[69] As R. V. Fletcher, General Counsel of the Association of American Railroads, testified, rates of different modes, "must be fixed, if they are fixed at all, by regulating authority so as to recognize and preserve the inherent advantages of each, and one of those inherent advantages obviously would be the question of cost. If it is cheaper to move on the highways, it would be perfectly proper that there should be a difference in rates." [70]

The district court reads the Congressional rejection of a rigid full cost rule as an endorsement of an equally rigid out-of-pocket cost rule. The legislative history belies this interpretation. Congress agreed to omit the Miller-Wadsworth amendment only after assurances, (1) the amendment would operate to increase many railroad rates that were set below full costs for reasons completely unrelated to water competition, and (2) the inherent advantages of water carriers were fully protected under the wording of the National Transportation Policy. This legislative history can be read to justify the interpretation that Congress looked upon the Policy as authorizing in competitive cases the full cost rule that the Miller-Wadsworth amendment would have required throughout the railroad rate structure. The history at the very least conveys the thought that the Congress deferred to the Commission's request for a broad discretion to adopt such cost standard as experience might prove to be useful, including a full cost standard in an appro-

[69] Senate hearings, note 50 *supra*, at 223.

[70] *Id.*, 53.

priate case. The history cannot support the lower court's view that Congress turned on itself, upset the carefully constructed language of the Policy and the recognized need of so many years for protecting the inherent cost advantages of water transportation, and approved a course of unrestrained out-of-pocket rate-making by the railroads in competition with the water carriers.

4. *Transportation Act of 1958.* We submit Congress did not adopt a rule of out-of-pocket competitive rate-making; and we further submit that the railroads themselves did not believe Congress had adopted such a course, as the railroads' subsequent efforts to obtain such legislation—this time expressly rejected by Congress—demonstrate.

The Commission commenced to interpret the 1940 transportation policy as if there had been no basic change of statutory emphasis since 1920. The new language was more comparable to the 1935 act, but there had been little or no experience in regulating minimum rates as between railroads and motor carriers. Hence, the Commission drew on its experience under section 4 and defined the issues raised by a rail rate reduced to meet water competition in terms of whether the reduction was "lower than necessary to meet the competition." The Commission made no effort to define or to protect particular "inherent advantages" of water transportation. At the same time, it held in *New Automobiles in Interstate Commerce,* 259 I.C.C. 475, 538 (1945), "there appears no warrant for believing that rail rates * * * should be held up

to a particular level to preserve a motor-rate structure or vice versa."

The railroads at first sought legislation that would broadly have permitted their filing any rate above out-of-pocket costs. The history of Congress' refusal to enact the "three-shall-nots" is set forth in this Court's *New Haven* opinion, 372 U.S. at 753–55, and will not be repeated. Suffice it to say that if the railroads had thought the statute already incorporated an out-of-pocket rule, these efforts surely would not have been made by the railroads. In any event, Congress' rejection of the "three-shall-nots" convincingly shows that it did not intend either the 1940 or the 1958 acts to incorporate an out-of-pocket rule.

The railroads eventually merely drew Congress' attention to the numerous cases [71] since 1940 in which the Commission had decided a competitive rate situation in terms of whether the reduced rate was "lower than necessary to meet the competition." They then contrasted this line of cases with the holding in *New Automobiles*, where the Commission had stated it would not hold up railroad rates merely to protect the traffic of the water carriers. The railroads again requested relief comparable to the "three-shall-nots."

Congress redrew section 15a(3) to reemphasize that the Commission may step in to oversee intermodal competition if the reduced rate threatens to impair or destroy an inherent advantage of the competing mode.

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[71] See list of cases set forth in the Hearings on S. 3778 before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 86–91.

As this Court stated in *New Haven,* "the principal reason" for the reference to the National Transportation Policy in section 15a(3) was "to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes" (372 U.S. at 758).

It should be added that during the debates over the Transportation Act, the late Senator Kefauver asked Senator Smathers, the bill's sponsor, the very question before this Court. He first noted, "A barge line competes with a railroad in all of its services; but a railroad may compete with a barge line only with respect to a very small part of the railroad service." He then asked whether it was "possible" for a railroad to make a rate to compete with a barge line "without considering its overhead," or does the transportation policy "require the railroad to take into consideration a part of its overhead in making its rate to compete with the barge line?" [72] Senator Smathers replied that the water carriers have not opposed the revised language of Section 15a(3), and "personally, I am of the opinion that they are adequately protected." The Commission may approve rail rates, "irrespective of the direct relationship it may have to another mode of transportation, so long as such rates do not result in unfair competitive practices." [73]

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[72] 104 Cong. Rec. 10859–59.

[73] *Id.* at 10859. The Department of Justice interpreted this colloquy in its *New Haven* Brief as showing that "Senator Smathers apparently agreed that the amendment would prohibit a rate which, by failing to return full costs, would infringe the inherent advantage of a competing lower-cost mode" (p. 34, note 13).

The lower court's decision contradicts the basic purpose of the 1958 legislation. Congress amended section 15a(3) to reemphasize the basic policy of recognizing and preserving inherent advantages of competing modes. The district court adopts the out-of-pocket cost standard, however, without regard to specified inherent advantages of any mode, and, as discussed earlier, runs contrary to certain known inherent cost advantages of the bargelines.

IV. THE COMMISSION RATIONALLY CHOSE FULL COSTS OVER OUT-OF-POCKET COSTS TO RECOGNIZE AND PRESERVE THE INHERENT COST ADVANTAGES OF THE WATER CARRIERS

The evidence of record was presented in terms of a choice as between out-of-pocket costs, favored by the railroads, and fully-distributed costs, favored by the water carriers. As we shall see, the choice of the full cost measure fulfilled the basic statutory requirement that the Commission "recognize and preserve the inherent advantages of each mode."

1. THE WATER CARRIERS POSSESS AN INHERENT COST ADVANTAGE

The major distinction between railroads and water carriers that Congress stressed in the legislative history we have discussed was, (1) *railroads,* and hence shippers by railroad, must pay for the rail right-of-way, but (2) *water carriers,* and shippers by water, do not have this cost. The water right-of-way is a natural advantage, or its improvements are paid for by the general public, rather than by shippers as a class. The lack of a right-of-way cost was firmly recognized as an inherent cost advantage of the water

mode of transportation. Moreover, the legislative history makes clear that Congress intended the Commission to recognize and preserve at least this inherent advantage, if not others, of the water carriers.

The present record showed that the foregoing cost advantage inhered in the operations of the present water carriers. The Mississippi Valley Barge Line, a water carrier directly affected by the proposed rate reduction, operates on the Ohio River and its tributaries. Its cost computation (Exhibit 24) included no user charges relating to any waterway or port. The formula used to develop its costs (Barge Form C) recited in the initial "Explanatory Statement" that port costs would "seldom be incurred by a carrier in the movement of bargeload traffic."

Each one of the economic witnesses appearing for the railroads also recognized the inherent cost advantage that the bargelines possessed. The fact was not disputed, for each one conceded, at least in general terms, that water carriers are exempt from the right-of-way costs borne by the railroads.

The Commission, therefore, approached the choice as between full costs and out-of-pocket costs with the fact essentially admitted on this record that the water carriers did not incur right-of-way costs, and the further fact that railroads possessed heavy right-of-way costs. Indeed, the rail witnesses characterized much of the rail right-of-way cost as "excess capacity."[74] The thrust of their testimony was, as we have seen,[75] (1) that the railroads in their own interest

[74] Page 8, *supra*.

[75] Pages 6 to 9, *supra*.

must use out-of-pocket pricing to make maximum use of their capacity and thereby maximize their profits, and (2) that the railroads in using out-of-pocket pricing would successfully defeat any cost advantage of the water carriers.

2. THE CHOICE OF FULL COSTS WAS RATIONALLY SUPPORTED BY ADEQUATE FINDINGS

The Commission found that a proper cost comparison cannot ignore constant costs (A. 40–41). If the railroads ignore constant costs they thereby ignore certain costs that they must bear and that their water carrier competitors inherently do not bear. The inquiry into whether a particular rate covers out-of-pocket costs and will maximize the proponent carrier's profit does not end the Commission's task; it merely precedes the cost comparison with the competing mode.[76]

The Commission referred to its decision in the *Grain* case as an example of its recognition that the full cost standard has "generally been employed in measuring inherent cost advantages in intermodal competitive rate controversies."[77] The Commission had expressly recognized the bargelines' inherent cost advantage in the *Grain* case. "For more

[76] See A. 67–68, and this Court's *New Haven* opinion, 372 U.S. at 760, notes 12 and 13.

[77] A. 65–66. Similarly, the division in the present case also referred to the *Grain* case (A. 41). The district court states that the Commission has not consistently employed a full cost standard (A. 22; 268 F. Supp. at 78). The court erred for it cited and relied on cases in which inherent cost advantage was not an issue. For cases where the issue has been presented, see pp. 48–49, *infra*.

than a century, an essential characteristic of such [water] transportation has been its dependence upon the free use of inland waterways developed and maintained by governmental agencies" (321 I.C.C. at 590). Rather than espouse a cost comparison that ignored these costs on the rail side of the comparison, the railroads there sought to accomplish the same result by increasing the water carriers' cost by so-called "public costs." The Commission refused to adjust upward the water carriers costs, like its present refusal to adjust downward the rail costs. The Commission would not consider the costs of building and maintaining the water carriers' right-of-way, since the established Congressional policy has been to exempt inland waterway carriers from paying user charges; "Congress has concluded, in effect, that barge transportation should be encouraged and that the resulting public benefits justify the cost involved" (*ibid*).[78]

The Commission held in the *Grain* case, incorporated by reference in its present opinion, that, "Inherent advantages must be determined on the basis of costs of operation which the different modes actually bear and not on the basis of hypothetical costs which would have been incurred if the historic policy of the Congress were different" (at 592). Congress apparently recognizes that it has given a cost advantage to the water carriers in their competition with the railroads, for obviously, "the injection of such construc-

[78] The Commission added that Congress has conferred certain cost benefits on the railroads including "such items as flood control benefits, harbor improvements, occupancy of public streets, tax relief, Government loans, and various minor subventions" (321 I.C.C. at 592).

tion costs [of inland waterways] into the cost structures of the bargelines would make their traffic more susceptible to diversion by other modes" (at 590–91).

The railroads' primary argument before the Commission in the present case was that no comparison of costs should be made; but rather that the Commission should enhance their profitability and assume their greater efficiency by permitting out-of-pocket pricing to meet the water carrier rate.[79] The Commission disagreed, stating that the determination of which mode possesses an inherent cost advantage requires "a comparison of the cost advantages of two competing modes of carriage" (A. 65). As this Court had stated in *New Haven,* the Commission must pass upon the precise "measure * * * for comparing the costs of two or more modes of transportation" (372 U.S. at 760, note 13). The Commission summarily rejected the railroad contention regarding efficiency, stating they had not shown they were "the more efficient" of the two competing modes. The ability to use out-of-pocket pricing is not an inherent advantage, first, within the meaning of the transportation policy, nor secondly "in the circumstances here present" where the competing mode possesses an admitted cost advantage (A. 67–68).

Finally, the Commission underscored the importance of this traffic to the competing bargelines. Iron and steel products, which includes ingot molds, is the

[79] Similarly, the Department of Justice urged in the district court that the determination of inherent advantage should be left to the "judgment of the marketplace," and that a comparison of costs is "not a relevant element of the rate proceedings." Brief of the United States, page 26.

third most important commodity group transported in barge service, and accounts for nearly 11 percent of bargeline revenue. These products are one among the limited number (just eleven) which account for 81.45 percent of total barge revenue. Out-of-pocket pricing by the railroads in this context would, therefore, "impair the ability of a carrier [bargeline] not only to compete but to exist (A. 68).

We submit that, contrary to the statements of the district court (A. 18–24), the Commission's findings adequately support its reliance upon a full cost comparison. The task of the district court was to determine whether a rational basis supported the decision reached by the Commission. *Mississippi Valley Barge Line Co.* v. *United States,* 292 U.S. 282, 286–87 (1934). It is sufficient if the "essential basis" of the Commission's order appears, *Alabama G.S.R. Co.* v. *United States,* 340 U.S. 216, 227–28 (1951), "so that a court can satisfy itself that the Commission has performed its function." *Luckenbach S.S. Co.* v. *United States,* 122 F. Supp. 824, 828, (S.D.N.Y., 1954), aff'd 347 U.S. 984. Moreover, if satisfied that the decision of the Commission in a complicated case does not involve gross error or unfairness, the district court's review function is at an end. *Penn.-Central and N & W Inclusion Cases,* —— U.S. ——, 19 L.ed. 2d 723, 749 (1968); and see *Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602–03 (1944).

The end result of the Commission's choice of full costs is fair to both sides. It succeeds in accomplishing the Congressional purpose precisely where the out-of-pocket measure fails.

The barge full costs and out-of-pocket costs are generally comparable.[80] On an out-of-pocket basis, the rail carriers are the low cost mode ($4.69 rail v. something under $5.19 barge-truck). However, an out-of-pocket comparison omits on the rail side certain constant costs, such as right-of-way costs, which the bargelines inherently do not incur. If only the constant right-of-way costs of the railroads in this proceeding (69.2 cents[81]) are added to their out-of-pocket costs ($4.69), then the bargelines become the low cost mode ($5.38 rail v. under $5.19 barge-truck). To show they were the low-cost mode, it was necessary to the rail position to exclude all their constant costs from the comparison. The Commission might have added only their constant right-of-way costs to out-of-pocket costs in the comparison and still have concluded that the rail publication of a $5.11 rate was below the cost of the low cost mode.[82] The Commission's using full costs (*i.e.*, adding all constant costs to out-of-pocket costs) made certain that the costs on the rail side of the comparison included the necessary constant costs which the bare out-of-pocket comparison ignored.

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[80] See Exhibit 24, Explanatory Statement and A. 201–203, 229–30. In *New Automobiles* the Commission stated that a water carrier's out-of-pocket costs typically will closely approximate its fully-distributed costs, "excluding only some of the general expenses" (259 I.C.C. at 508).

[81] The rail right-of-way portion of their constant costs includes road property depreciation of 2.5 cents; return on road property, freight, of 52.5 cents; and roadway and structures maintenance of 14.2 cents. See Appendix A.

[82] We, of course, do not suggest the Commission should or must use full costs in every proceeding, nor that the bargelines are favored by only the right-of-way cost advantage.

The district court questioned the reasons for using "an out-of-pocket cost comparison to determine which of the competing modes has an inherent advantage in situations where there is substantial competition from unregulated carriers," citing the *Grain* case as an example of such a comparison.[83] The court confused the role of the Commission in the presence of significant unregulated competition. The Commission has not considered "inherent advantages" in that context, because no unregulated carrier has ever presented such costs in any proceeding. Literally, the National Transportation Policy applies only to "modes of transportation subject to the provisions of this Act." Section 15a(3) on its face also applies only in cases "involving competition between carriers of different modes of transportation subject to this Act." Obviously, different considerations may be controlling in the presence of substantial unregulated competition. In any event, the present case does not pose any issue as to whether the Policy and the Act are intended to protect asserted inherent advantages of unregulated carriers.

In *New Haven,* this Court referred to the standard of full costs as an appropriate and permissible measure of the low cost advantage as between competing modes. The Court referred to a full cost comparison as "the precise example given to the Senate committee, which led to the language adopted" in the 1958 revision of Section 15a(3) (372 U.S. at 758). The Court there referred to "a case in which the railroads, by establishing on a part of their operations a com-

[83] A. 21; 268 F. Supp. at 77.

pensatory rate below their own fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed cost" (*id.*, emphasis is that of the Court.)

To be sure this Court did not rule out "hard competition" where rail rates exceed rail full costs (372 U.S. at 759); and it is just such hard competition that has resulted under the standard followed by the Commission since the *New Haven* case. Where proposed rates of railroads have exceeded their fully distributed costs, the Commission has approved them, virtually regardless of the effect on competition. *E.g., Pig Iron, Buffalo, N.Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121, 128, 130 (1963); *Steel Bars Lemont Ill., to Iowa, Kans., Mo., Minn. & Nebr.*, 319 I.C.C. 292, 301, 303 (1963).

Hard competition has resulted in many areas besides iron and steel commodities since *New Haven*. For example, the Commission approved reduced rail rates on sugar from Gulf and South Atlantic ports to Ohio River crossings in July, 1959, over the protest of barge lines, upon finding the rates exceeded rail full costs. *Sugar to Ohio River Crossings*, 308 I.C.C. 167, 185–186 (1959). The barge lines in November, 1959, sought to meet the rail reductions, which led to further reductions in the rail rates. Both of the subsequent reductions were approved by the Commission upon finding they both exceeded the respective fully distributed costs of each mode, and could not be considered destructive competitive practices. *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 785 (1963). Only where the rail rates have been below their fully distributed costs, and be-

low the full costs of competing modes of transportation, have they been disapproved. See, *e.g., Pig Iron, Buffalo, New York, to Chicago, Ill., and Gary, Ind., supra,* at 128–130 (1963).

One of the positions asserted by the railroads before the Commission was, as the entire Commission stated, that allegedly "no reliable intermodal cost comparison can be made and none should be attempted" (A. 63).[84] As the litigation progressed through the district court,[85] the railroads embraced a cost comparison that, in lieu of adding "public costs" to the costs of the water carriers, omitted all the rail constant costs in the comparison.[86] With this partial cost comparison,

[84] *E.g.*, see testimony of witness Baumol (A. 84, 229–30, 236). In the district court, the railroads complained that the full cost comparison included a pro-rata portion of their passenger and less-than-carload deficits. However, the Commission accepted their own computation of their full costs, which included these deficits; and the objection was waived when it was not presented in the brief or petition for reconsideration before the Commission. *United States* v. *L. A. Tucker Truck Lines*, 344 U.S. 33, 36–38 (1952). Moreover, a witness for the railroads conceded that "the passenger and LCL deficits are also to be recovered" in the railroads' constant costs (Exhibit 38, p. 23; A. 154). The inclusion of these expenses in full costs was sustained by this Court in *King* v. *United States*, 344 U.S. 254, 266–67 (1952) in another rate contest. Finally, the inclusion of these deficits was not prejudicial, for they amounted to only 66.9 cents of the rail full cost of $7.59, (see Appendix A); their exclusion would have not affected the result (see page 46, *supra*).

[85] Contrast the railroads' petition for reconsideration before the Commission with their briefs below.

[86] The economic witnesses for the railroads went even further. They would either have omitted from the cost comparison a portion of the out-of-pocket right-of-way costs of the railroads (see testimony of witness Edwards, A. 158, 241); or would have adjusted the out-of-pocket costs of the water carriers upward for socalled "public costs" (*e.g.*, witness Baumol, A. 236; and witness Heflebower, A. 134–35).

the railroads sought to accomplish what they had failed to accomplish in the *Grain* case, namely a cost comparison that ignored the bargelines' inherent cost advantage of not having any right-of-way costs.

The railroad effort to defeat the bargelines' inherent cost advantage on this record by urging a cost comparison that circumvented that advantage was no less unsound than their comparable effort to circumvent such an advantage by the publication of discriminatory rates, which this Court condemned in *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567 (1947). As this Court noted, the grain rates into Chicago were cheaper by barge than by rail, since the bargelines were "less expensive to operate and therefore could afford to transport freight much more cheaply than railroads" (at 570). The railroads sought to defeat this inherent advantage by charging more for reshipping the grain out of Chicago when it had arrived at Chicago by barge than when it had arrived by rail. The Court reversed the Commission's approval of these rates, stating that "Congress left the Commission no discretionary power to approve any type of rates which would reduce the 'inherent advantage' of barge transportation in whole or in part" (at 579).

We submit the Commission properly relied upon a full cost comparison which on this record was the only measure that insured that the cost advantage of the bargelines would be recognized and preserved.

CONCLUSION

The judgment of the district court should be reversed and the cause remanded with instructions to dismiss the action.

Respectfully submitted.

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MARCH 1968.

APPENDIX A

Effect of right-of-way costs and railroad deficits in a comparison of rail and bargeline full costs

(1)	Eastern district (2)	Southern region (3)	Total (4)
1. *Fully distributed cost per ton*	515.7¢	243.7¢	789.4¢
2. *Total cost*, including return, freight [1]	$2,937,490,290	$1,139,392,535	
3. *Passenger deficit*, expenses, rents & taxes except Fed. Income	121,433,080	69,169,051	
4. Return on passenger portion of road & equipment	75,146,082	25,750,666	
5. Passenger deficit—Total	196,560,162	94,919,717	
6. Percent passenger deficit of total freight costs. Line 5+ line 2	6.7%	8.4%	
7. Amount passenger deficit included in F.D. Costs. Line 1 times line 6 (all in constant costs)	34.6¢	20.5¢	55.1¢
8. *LCL Deficit*—expenses, rents, taxes, except Fed. Income	32,431,838	19,384,247	
9. Return on LCL portion of road & equipment	6,499,020	4,794,656	
10. LCL deficit—Total	38,930,858	24,178,903	
11. Percent LCL deficit of total freight costs. Line 10 + line 2	1.3%	2.1%	
12. Amount LCL deficit included in F.D. Costs. Line 1 times line 11 (all in constant costs)	6.7¢	5.1¢	11.8¢
13. *Road property—depreciation*	49,204,136	18,640,994	
14. Normalized depreciation of amortized road property	538,599	260,283	
15. Total road property depreciation in F.D. costs	49,742,735	18,901,277	
16. Percent depreciation of total costs. Line 15 + line 2	1.69%	1.66%	
17. Amount depreciation of total costs. Line 1 times line 16	8.7¢	4.0¢	12.7¢
18. Amount depreciation in constant costs	1.7	0.8	2.5¢
19. Amount depreciation in out-of-pocket costs	7.0	3.2	10.2¢
20. *Return on road property*—freight in F.D. Costs	394,748,923	166,954,686	
21. Percent return of total costs. Line 20 + line 2	13.44%	14.65%	
22. Amount road property return in total costs. Line 1 times 21	69.3¢	35.7¢	105.5¢
23. Amount road property return in constant costs	34.7	17.8	52.5¢
24. Amount road property return in out-of-pocket costs	34.6	17.9	52.5¢
25. *Amount of roadway & structure maintenance* in F.D. Costs (depreciation excluded)	248,314,562	127,454,131	
26. Percent roadway & structure maintenance of total costs. Line 26 + line 2	8.45%	11.19%	
27. Amount roadway & structure maintenance in total cost. Line 1 times line 26	43.6¢	27.3¢	70.9¢
28. Amount roadway & structure maintenance in constant costs	8.7	5.5	14.2¢
29. Amount roadway & structure maintenance in out-of-pocket costs	34.9	21.8	56.7¢

[1] The total costs are the amounts of expenses reported by the railroads in their annual reports to the Interstate Commerce Commission and include an allowance of a 4 percent return after Federal income taxes, on the depreciated original cost of road property and equipment.

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SUPREME COURT, U. S.

Nos. 797, 804, 808, 809

IN THE

Supreme Court of the United States

October Term, 1967

AMERICAN COMMERCIAL LINES, INC., et al.,
Appellants in No. 797

AMERICAN TRUCKING ASSOCIATIONS, INC., et al.,
Appellants in No. 804

THE AMERICAN WATERWAYS OPERATORS, INC.,
Appellant in No. 808

INTERSTATE COMMERCE COMMISSION,
Appellant in No. 809

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, et al.,
Appellees

On Appeal From the United States District Court for the Western District of Kentucky.

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LOUISVILLE AND NASHVILLE RAILROAD COMPANY, et al.,
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR RAILROAD APPELLEES [1]

1. The list of the Railroad appellees is found at A. 1-2.

I

THE QUESTIONS

1. Whether, in view of Section 15a(3) of the Interstate Commerce Act and the National Transportation Policy, the court below was right in holding that normally where reduced intermodal competitive rates are before the Interstate Commerce Commission, they should be approved if they exceed the proponent mode's out-of-pocket costs and are not detrimental to such mode's own revenue requirements?

2. Whether the court below was right in holding that in *Ingot Molds, Pa., to Steelton, Ky.*, 326 I.C.C. 77 (1965), the Commission's decision was without a rational basis and therefore arbitrary?

II

STATEMENT

This brief will answer the four briefs of the several appellants. While each of these briefs states the facts before this Court in somewhat different fashion, the facts, as such, are not in dispute. They are best summarized by the court below at the outset of its opinion.[2] But to give these facts added meaning, attention is invited to several of their significant features.

First, the Interstate Commerce Commission found that the reduced rail rate of $5.11 per gross ton on ingot molds is required by the railroads if they are to effectively compete for the traffic.[3]

Second, the reduced rail rate has found to be compensatory by the Commission since it exceeds the railroads' out-of-pocket costs as computed by the Commission's own Rail Form A formula[4] by 42.1 cents a ton.[5] A word or so

2. Louisville and Nashville Railroad v. United States, 268 F. Supp. 71, 73-75 (W.D. Ky. 1967); A. 12-16.

3. Ingot Molds, Pa., to Steelton, Ky., 326 I.C.C. 77, 78 (1965); A. 61-62.

4. Rail Form A is a formula developed and refined over the years by the Cost Finding Section of the Interstate Commerce Commission. One of its principal purposes is the determination of the costs incurred in providing a particular rail freight service. See EXPLANATION OF RAIL COST FINDING PROCEDURES AND PRINCIPLES RELATING TO THE USE OF COSTS—STATEMENT NO. 7-63 OF I.C.C. COST FINDING SECTION at 3 (1963). Similar formulas have been developed by the Cost Finding Section to compute the costs of motor and water carrier services. EXPLANATION OF THE DEVELOPMENT OF MOTOR CARRIER COSTS—STATEMENT NO. 4-59 OF I.C.C. COST FINDING SECTION (1959); FORMULA FOR DETERMINING COST OF TRANSPORTING FREIGHT BY BARGE LINES—STATEMENT NO. 6-62 OF I.C.C. COST FINDING SECTION (1964).

5. 326 I.C.C. at 78, 79; A. 62-63.

about this most significant, but somewhat misleading terminology. The term out-of-pocket costs, sometimes spoken of interchangeably with such terms as variable costs or incremental costs, as used in connection with Rail Form A, reflects "the added costs which [are] . . . incurred because the traffic in question [is] . . . handled or the costs which could [be] . . . avoided if the traffic [is] . . . not handled." Stated differently, out-of-pocket costs, as computed by Rail Form A, include all of the expenses occasioned by the rendition of a particular service. They include not only the direct expenses for labor, material, equipment and supervision, but assigned portions of overhead items, such as accounting expenses, executives' salaries and taxes. Often lost sight of, they also include 100 percent of the return on the depreciated investment in equipment and 50 percent of the return on the depreciated investment in roadway property.[6] Since the out-of-pocket costs reflect the costs incurred in rendering a particular service,[7] they are universally used by the Commission in determining whether any particular rate will produce revenues which are compensatory.[8]

Entirely apart from the expenses incurred by the railroads, or by any other mode, in furnishing an individual

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6. See Reduced Transcontinental Lumber Rates, 1961, 318 I.C.C. 815, 840-841 (1963); EXPLANATION OF RAIL COST FINDING PROCEDURES AND PRINCIPLES RELATING TO USE OF COSTS, I.C.C. COST FINDING SECTION STATEMENT No. 7-63 at 1-3 (1963). Since the out-of-pocket expenses include substantial amounts for return on investment, in many instances they overstate the actual expenses incurred in rendering a particular service. See FRIENDLY, *The Federal Administrative Agencies: The Need For Better Definition of Standards*, 75 Harv. L. Rev. 1263, 1271 (1962). This is true in Ingot Molds. See A. 143, 150.

7. See Chicago & N.W. Ry. v. Atchison, T. & S.F. Ry., 378 U.S. 326, 333-334.

8. Dairy Products From Twin Cities to Chicago, 321 I.C.C. 720, 724 (1964) Cement Within Southern Terr. & From Hagerstown to So., 319 I.C.C. 465, 478 (1963).

service such as the movement of ingot molds, there are other expenses which the enterprise as a whole must bear. These are the so-called constant expenses.

Constant expenses are those arising from facilities and activities which exist and must be maintained regardless of the amount of business conducted, or in fact whether any business is done. A typical example is the stone or steel railroad bridge across a river or the fencing along a railroad's rights-of-way. The expenses arising from such items exist and must be borne regardless of how much traffic goes over the bridge or past the fence. Adding new services or extending existing services does not increase such expenses. Included in the so-called constant expenses of the railroads are the deficits which regularly recur from the rendition of passenger services.

By their nature, since they are not occasioned by the rendition of any particular service, constant expenses cannot be assigned to any service except upon an arbitrary basis. This is not to say that the constant expenses do not have to be recovered. They must be if the enterprise is to remain viable. Whether they are recovered depends entirely upon whether the revenues in excess of the out-of-pocket costs generated from each item of traffic, in the aggregate will be sufficient to meet them. If the contribution to the constant expenses from each item of traffic is maximum by reason of the rate charged and the volume of business generated, the enterprise can do nothing more to cover its constant expenses.

With respect to the ingot molds rate, the Commission found that it would make a maximum contribution towards the railroads' constant expenses[9] and that therefore the railroads would be better off with the reduction than with-

9. 326 I.C.C. at 82; A. 67.

out it. This reduced rate therefore, far from being detrimental to the railroads' needs, is most constructive and helpful.

"Fully-distributed cost," when applied to a particular service, is economically and practically speaking, a poorly descriptive label. It is a composite number comprised of the ascertainable out-of-pocket costs of providing the particular service plus an arbitrary assignment of some portion of the total constant expenses.[10] The resulting number is thus partly cost and partly a hoped-for contribution towards the enterprise's constant costs.

These concepts just discussed are elementary and fundamental principles of economics, more fully explained by the economic testimony which was presented by the railroads and, to a large extent, ignored by the Commission.[11]

A third aspect of the facts should also be highlighted. Nowhere in the Commission's reports is there any finding to the effect that the reduced ingot molds rate is unlawful if judged by standards regularly and ordinarily applied where reduced carrier pricing is before the Commission. There is no finding, for example, this rate is discriminatory among shippers, prejudicial to locations, in violation of the long and short haul provision, predatory in the sense that it is aimed at the destruction of a competitor or involves unfair pricing practices. In fact this ingot molds rate has characteristics shared by an almost limitless number of rail and other carrier rates. Throughout the pricing structures of all modes, there are rates aimed at generating traffic in the face of competition, which are established above the out-of-pocket level but well below the artificial fully-distributed

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10. See Chicago & N.W. Ry. v. Atchison, T. & S.F. Ry., *supra*, n. 7 at 334; EXPLANATION OF RAIL COST FINDING PROCEDURES, *supra*, n. 6 at 1-6, 24-26.

11. See *e.g.*, A. 84-88, 91-95, 112-114, 118-119, 124, 130, 133, 140-141, 145, 158-159.

cost number. The appellants themselves state this to be the case.[12]

The Commission's sole basis for ordering the cancellation of the railroads' constructive pricing adjustment, which affords the shipper a choice of two competitive services at the same charge, is its conclusion that the railroads have "unlawfully impinged upon the ability of the barge-truck route competitively to assert its inherent cost advantage."[13] In addition, the Commission indicates that the ingot molds rate will only be allowed if it is raised, not to the level of any cost floor of the railroads but to the "fully-distributed cost" figure which it found applicable to the barge-truck route.

The court below, reviewing this anticompetitive result, which insures the barge-truck route of a monopoly of this particular traffic, concluded the Commission had not set forth a rational basis for its actions, and further, such actions were inconsistent with the relevant statutory standards interpreted in the light of their legislative histories.

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12. Some 65 percent of rail tonnage moves at rates below "fully-distributeld cost" A. 155. See brief of American Commercial Lines at 35-37.

13. 326 I.C.C. at 85; A. 71.

III

SUMMARY OF ARGUMENT

The court below has interpreted correctly the statutory standards for reduced intermodal competitive rates by holding that the Congress, by the enactment of the National Transportation Policy and Section 15a(3) of the Interstate Commerce Act, evidenced an "intent that reduced compensatory rates should normally be allowed." This interpretation has ample support in the legislative histories of the relevant statutory provisions.

The National Transportation Policy, which requires the Commission to "recognize and preserve the inherent advantages of each [mode]" is the preamble to the contemporary Interstate Commerce Act and is specifically an integral part of Section 15a(3) which contains the rule of ratemaking for reduced intermodal competitive rates. This policy, in its present form, was enacted as part of the Transportation Act of 1940. Its mandates, including the requirement that inherent advantages be recognized and preserved, reflect an earlier Policy statement which was applicable to the Motor Carrier Act of 1935.

The legislative history of the National Transportation Policy indicates that the objective was to require the Commission, in judging the lawfulness of the rates of any mode to do so with regard to such mode's own costs and transportation characteristics, rather than those of another competitive mode.

In *New Automobiles in Interstate Commerce,* 259 I.C.C. 475 (1945), the Commission made an exhaustive review of the legislative history of the National Transportation Policy and the then new rule of ratemaking contained in Section 15a(2) to determine the extent of its powers where one mode reduces its rates to respond to

the competition of another. The Commission concluded that the recognition and preservation of inherent advantages would be best accomplished by permitting each mode to reduce its rates to meet competition provided the reductions would be compensatory. For a rate to be compensatory, the Commission said it would have to exceed the proponent mode's own out-of-pocket costs. By adopting this cost standard, the Commission not only concluded that each of the several modes would be able to price its services to reflect its own inherent advantages but that the public would also benefit from the lower transportation charges brought about by effective competition.

By the enactment in 1958 of Section 15a(3), Congress intended to insure Commission adherence to the philosophy of *New Automobiles* from which it had deviated during the 1945-1958 period. *New Automobiles* supports the interpretation of Section 15a(3) of the court below because it stands squarely for the proposition that normally reduced intermode competitive rates should be approved if they are compensatory and not detrimental to the proponent mode's own revenue needs.

The use of "fully-distributed cost" floors, whether reflecting those of the proponent or competitive mode, as a device for recognizing or preserving inherent advantages, finds no support in the legislative histories of any of the relevant statutory provisions. Rather, the legislative history of the Transportation Act of 1940 provides a strong basis for the contrary view that "fully-distributed costs" should not be used as a rate floor. Congress, in its extended consideration of the powers the Commission should be given in determining the reasonableness of intermodal rate reductions, specifically rejected proposals which would have established "fully-distributed costs" as rate floors. Later, in 1958, it likewise rejected similar proposals in its consideration of Section 15a(3).

While the court below held that normally reduced rates should be allowed if compensatory, it plainly stated that its interpretation of Section 15a(3) is not an inflexible one. Deviations from the normal rule are permitted, the court below said, provided the Commission has a rational basis for doing so.

In *Ingot Molds,* the Commission, although it found: the railroads' reduced rate compensatory; not detrimental —but actually beneficial—to the railroads' revenue needs; and required for effective competition, concluded that the reduction was unlawful because it "impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage." The Commission further concluded that the reduced rail rate could only be lawfully maintained if it were substantially increased so as to exceed the "fully-distributed cost" level of the barge-truck route. By so doing, the Commission has required reduced railroad pricing not to reflect railroad costs but those of another mode. And it did this despite the presence of uncontroverted testimony to the effect that elementary and fundamental economic principles require a conclusion that inherent advantages will be best recognized and preserved by establishing as a floor for reduced rates the proponent mode's own out-of-pocket costs and that there is no justification for using "fully-distributed cost" floors—and particularly those of another mode—for such purposes.

The only justification given by the Commission for its approach which establishes artificial restraints upon free and fair competition is that it has done so before. But in none of the earlier cases relied upon is there any rationale given for the use of "fully-distributed cost" floors. And as the court below points out, the Commission in this area has evidenced the greatest inconsistency, and has frequently permitted reduced rates upon a showing that

they are compensatory and responsive to intermodal competitive urgings.

The court below held that the Commission's report contains no rational basis for the perfunctory conclusions reached and that therefore it is arbitrary and must be set aside. While the appellants take issue with this holding, it seems apparent that they also feel the Commission's actions lack a rational basis. This is evidenced by their attempts to provide a *post hoc* rationalization for the Commission's conclusions.

The *Chenery* doctrine requires the Commission's actions to be judged upon what its report contains and not upon after supplied reasons and rationalizations, and therefore the appellants newly conceived rationale, first presented before this Court, should fail. But assuming, for argument purposes only, that this new rationale is properly presented here, it must nevertheless fail because it is wholly lacking in substantive merit.

The appellants contend that only by utilizing fully-distributed costs, both as the measure of inherent advantages and as a floor to preserve such advantages, can recognition be given to the fact that motor and water carriers have the "inherent" or "natural" advantage of using Government supplied rights-of-way, either free or without the payment of adequate user charges, and that by contrast the railroads must pay for their rights-of-way out of their own pockets. This contention is wrong because the cost formulas developed by the Commission for determining out-of-pocket costs give full recognition to this situation regardless of its obvious unfairness and inequity. The out-of-pocket costs developed by the use of the Commission's own formula for the barge-truck route in *Ingot Molds*, include no expense items to cover the costs of the Government in supplying rights-of-way to the barges and the trucks. Therefore, the "advantage" of the barges and

the trucks in using Government supplied facilities free, or for inadequate user charges, is given complete recognition when their own out-of-pocket costs are used as the floor for their rates.

By startling contrast, the out-of-pocket costs of the railroads in providing the ingot molds service—as computed by the Commission's formula—include all of the railroads' right-of-way expenses which the Commission regards as being incurred in providing such service, plus a substantial return on the investment in the roadway facilities. Thus, the use of the railroads' out-of-pocket costs as the floor for reduced rail rates gives full recognition to the disabilities the railroads must bear in paying for their own rights-of-way.

What the appellants, by advocating the use of "fully-distributed cost" floors, are seeking is not the recognition and preservation of inherent advantages, but the establishment of artificial and uneconomic pricing restraints which will deny the railroads the right to enjoy their inherent cost advantage and to thereby compete effectively with other modes. And, more importantly, the position of the appellants will deprive the public of the benefits of competition in the form of lower transportation charges.

IV

ARGUMENT

The court below, in its opinion, first directs its attention to the claim that the Commission's order lacks a rational basis and therefore constitutes arbitrary action which a reviewing court should set aside under the Administrative Procedure Act.[14] None of the appellants quarrels with the right of the reviewing court to set aside administrative agency action, if in fact it lacks a rational basis. But in each of the four briefs it is claimed that the Court below has erred in holding that the required rational basis is not present.[15]

It appears that each of the appellants is less concerned with the holding of the court in this area than with its second holding that the "Commission's order is based upon a "misinterpretation or misapplication of the relevant statutory provisions" and ". . . is therefore not in accordance with law."[16] Each of the appellants' briefs directs its first and most important efforts to show error in this holding.

Although the railroad appellees believe either basis advanced by the court below alone is sufficient to require affirmance of its judgment that the order of the Commission be set aside; and that the questions were dealt with in the proper sequence below, to facilitate argument here the appellants' contentions will be answered in the order presented.

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14. 268 F. Supp. at 75; A. 16-17, 5 U.S.C. §§ 1001-1011.

15. Briefs of Commission at 40-50, American Commercial Lines at 39-55, American Trucking Associations at 20-25, American Waterways Operators at 12-18.

16. 268 F. Supp. at 79, 82; A. 25, 31.

A. The Court Below Correctly Held Congress Has Evidenced an Intention That Normally, in Intermodal Competitive Situations, Carriers Should be Free to Compete for Traffic by Compensatory Pricing Reductions Which Are Not Detrimental to Their Own Revenue Requirements

After an exhaustive review of the legislative history of Section 15a(3) of the Interstate Commerce Act, which contains the statutory standards for judging the lawfulness of reduced intermodal competitive rates, and of the Transportation Act of 1940,[17] which brought into effect both the National Transportation Policy and the rule of rate-making found in Section 15a(2)[18] which was refined by the enactment of Section 15a(3), the court below reached this conclusion:

> We believe that the Commission failed to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs . . .
>
> We do not mean to suggest that there may not be situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory. What we do suggest is that Congress has expressed a clear intent that reduced compensatory rates should normally be allowed and that the record here and the Commission's report supply no basis for disregarding that intent.[19]

The appellants, differing among themselves as to the reasons, argue that this conclusion is wrong. The Com-

17. 54 Stat. 899-956.
18. 49 U.S.C. § 15(a) 2.
19. 268 F. Supp. at 82-83; A. 31-32.

mission and American Commercial Lines take the position that the Court's interpretation lays down an excessively rigid rule of law which seriously interferes with, or may even destroy, the Commissions' power to preserve inherent advantages.[20] American Trucking Associations contends that the conclusion is not supported by the bases set forth.[21] American Waterways Operators seems to take the position that the conclusion of the court below regarding the purpose of Section 15a(3) is wrong because it does not protect the water carriers from "out-of-pocket competitive ratemaking" and infers that the purpose of the Congress was to outlaw such pricing.[22]

From the language of the court below, it is apparent that it did not intend to withhold from the Commission jurisdiction to review intermodal pricing reductions to determine whether they will destroy the inherent advantages of another mode. But the court did say that before the Commission should condemn a reduction which would not be detrimental to the proponent mode's own revenue requirements and which would afford the shipping public the benefits of competition in the form of lower charges, it should have strong and well articulated reasons for doing so. Such reasons, it said, are not found in the Commission's report. In reaching this conclusion, supported by its review of the legisative histories of the controlling statutory standards, the court below was expressing the same thought as this Court had reached upon its own review of the legislative history of Section 15a(3) in *New Haven*.[23] This Court there said:

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20. Briefs of Commission at 12-13, American Commercial Lines at 11-15.

21. Brief of American Trucking Associations at 7-20.

22. Brief of American Waterways at 10-16.

23. I.C.C. v. New York, N.H. & H. R.R., 372 U.S. 744.

> If a carrier is prohibited from establishing a reduced rate that is not detrimental to its own revenue requirements merely because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service. (372 U.S. at 759)

Since a reduced rate which is above out-of-pocket costs is compensatory, it will be beneficial to the proponent mode's revenue requirements if, by reason of the traffic volume it generates, the aggregate amount realized above the out-of-pocket costs exceeds that from its previous higher rate. Here, as the Commission found, the reduced ingot molds rate, by attracting traffic, will increase the contribution to the railroads' constant expenses and therefore is precisely the type of enjoyment of inherent advantage which this Court, in *New Haven*, indicated the legislative history of Section 15a(3) approves.

The court below, upon its own review of the legislative history, reached the identical conclusion of this Court in *New Haven*, that Section 15a(3) "was designed to reaffirm the intent of the 1940 Act, an intent that had been correctly construed by the Commission in 1945 in *New Automobiles in Interstate Commerce*, 259 I.C.C. 475, but which in the Committee's view, had not been consistently followed."[24] The lower court's language was only slightly different.[25]

The court below was also impressed with the fact that in *New Automobiles* the Commission had found that a compensatory rate is one which exceeds out-of-pocket costs, and that such rates normally should be allowed so that the public would have the benefit of for-hire transportation at rates reduced in response to the urgings of intermodal competition.[26]

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24. 372 U.S. at 756.
25. 268 F. Supp. at 80, 82; A. 26, 31.
26. 268 F. Supp. at 81-82; A. 29-30.

To have supported its position, the court below could have quoted from the Commission's own finding in *New Automobiles:*

> A reasonably compensatory rate is one which is remunerative, i.e., covers the out-of-pocket costs, as hereinbefore defined, of handling the particular traffic under consideration, including a proper return on investment . . .
>
> As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, there appears no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa.
>
> It is obvious that rate reductions cannot be halted by the prescription of minimum rates unless the existing rates have fallen below a reasonable minimum level. According to the cost studies the rates of the several forms of transportation are generally compensatory, except in scattered instances. Within reasonable limits the public is entitled to the reduced rates brought by competition. (259 I.C.C. at 538-539)

The court below might further have pointed out that the Commission, in *New Automobiles,* in reaching the conclusion that—under the National Transportation Policy and the then new rule of ratemaking in the Transportation Act of 1940—compensatory rates normally should not be interfered with, made a detailed examination of the extent of its minimum rate powers in intermodal competitive situations. Based on this examination, the Commission stated

such powers should be used "sparingly"[27] and "Generally its application has been confined to instances in which we have found that a rate was so low as needlessly to sacrifice a carrier's revenue."[28] And, in *New Automobiles*, the Commission iterated[29] the thought it had earlier expressed in *Seatrain Lines, Inc. v. Akron, C. & Y. Ry.*, 243 I.C.C. 199, 214 (1940):

> . . . it is of interest that the rule of rate making in section 15a has been recently amended so as to require us, in the exercise of our authority to prescribe just and reasonable rates, to "give due consideration, among other factors, to the effect of rates upon the movement of traffic *by the carrier or carriers for which the rates are prescribed* * * *." This admonition is repeated in sections 216(i) and 307(f), containing rules for rate-making relating to motor and water carriers, respectively. The words which have been italicized for emphasis are of particular interest. They were not in either of the bills originally passed by the Senate and the House of Representatives but were added by the committee of conference. Their meaning, supported also by the legislative history, seems to be that no carrier should be required to maintain rates which would be unreasonable, judged by other standards, for the purpose of protecting the traffic of a competitor.

Since in *New Automobiles* the demand by the adversely affected intermodal competitors was that the Commission, in order to preserve inherent advantages,[30] should disapprove rates reduced on an out-of-pocket basis, and this de-

27. 259 I.C.C. at 535.

28. *Idem.* Quoting from Petroleum and Petroleum Products, Calif. to Ariz., 241 I.C.C. 21, 41 (1940).

29. *Id.* at 536-537.

30. *Id.* at 539.

mand had been rejected by the Commission, the court below quite properly felt that *New Automobiles* supports the proposition that normally compensatory rates, which are not detrimental to the proponent carrier's own revenue requirements, should be permitted.

(1) There Is No Merit in the Appellants' Contention That the Court Below Has Erred in Holding That the Philosophy of New Automobiles Applies to Ingot Molds

As the arguments of some of the appellants are understood, they do not deny that the objective of the Congress in enacting Section 15a(3) in 1958 was to admonish the Commission to ahere to the philosophy of *New Automobiles*.[31] But they claim reliance upon it is misplaced because in that case the concern was not with the recognition and preservation of inherent advantages. This contention is patently wrong for two reasons. First, because the motor carriers in *New Automobiles* specifically asked that the reduced rail rates, although compensatory, be ordered increased to preserve their inherent advantages,[32] and second, because the Commission expended considerable effort in comparing the costs of the two comparative modes to determine which had the inherent advantage of lower costs.[33] It is significant that in making this determination. the comparison essentially was of the out-of-pocket costs of the two competing modes.[34]

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31. See S. Rep. No. 1647, *Transportation Act of 1958,* 85th Cong., 2d Sess. at 2, 3 (1958); H. Rep. No. 1922, *Transportation Act of 1958,* 85th Cong., 2d Sess. at 14 (1958).

32. 259 I.C.C. at 530, 539.

33. *Id.* at 506-513, 529, 539.

34. The Commission compared the costs of the railroads with those of other modes to determine "relative fitness of various agencies of transportation," *id.* at 529, and concluded that for distances of beyond 175 miles the railroads were the "fitter agency" *idem.* The com-

But assuming, for argument purposes only, that there may be slight factual differences between *New Automobiles* and *Ingot Molds*, the philosophy of *New Automobiles*, which the Congress sought to preserve by enacting Section 15a(3) condemns *Ingot Molds*. *New Automobiles* stands for the proposition that the Commission shall not deprive the public of reduced rates flowing from intermodal competition, if such reduced pricing is compensatory and not detrimental to the proponent carrier's own revenue requirements. The reduced ingot molds rate passes this test with flying colors because it makes a maximum contribution to the railroads' constant expenses and at the same time affords the shippers two competitive services at equal prices.

While attention is focused upon the analysis of the legislative history, it should be noted the court below also directs attention to statements in the Congressional Debates and Reports which provide additional support for the view that normally the Commission should not interfere with reduced intermodal rates which are compensatory.[35]

(2) The Court Below Was Right in Relying Upon the Rejection by Congress of the Miller-Wadsworth Amendment as Additional Support for Its Position That Normally Compensatory Rates Should Be Permitted

The court below looked beyond *New Automobiles* to determine whether there was anything in the legislative history of the Transportation Act of 1940 which would cast

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parison was of rail out-of-pocket costs and the other mode's fully-distributed cost, *idem*, but this was intended to be a comparison of out-of-pocket costs because the Commission found generally that over the long-range the motor and water carriers' out-of-pocket costs were identical with their fully-distributed costs. *Id.* at 506, 508.

35. 268 F. Supp. at 80-81, A. 27-28.

any doubts upon whether the Commission's *New Automobiles* phiolosphy would carry out the intentions of Congress. Based upon this examination, the court below concluded that the Commission was at that time right, and further the Congress itself, by rejecting proposals for the establishment of "fully-distributed cost" floors, including the Miller-Wadsworth amendment, had evidenced the belief that the public interest would best be served by permitting carriers to reduce rates below "fully-distributed costs," providing they are compensatory.[36]

Appellants argue that the court below has placed too much reliance upon the rejection by Congress of provisions in the earlier versions of the Transportation Act of 1940 which would have established "fully-distributed cost" floors, as a basis for its contention that normally reduced rates exceeding out-of-pocket costs should be permitted.[37]

They contend that the legislative history, including the rejection of such provisions as the Miller-Wadsworth amendment, favors the view that the Commission should be given complete flexibility in adopting standards for preserving inherent advantages. Nothing in what the court below says takes from the Commission the power, in the first instance, to preserve inherent advantages. That right is specifically retained, but the court below quite properly says that the Commission may not, in the light of Congress's disapproval of "fully-distributed cost" floors, arbitrarily impose such floors under the guise of preserving inherent advantages. But this is precisely what the Commission did in *Ingot Molds*.

It is not a little paradoxical that while the Commission here argues that the court below has imposed restraints

36. 268 F. Supp. at 82; A. 31.

37. Briefs of Commission at 30-37; American Trucking Associations at 13-16.

which interfere with its flexibility—which the court below says is not the case—the Commission, in *Ingot Molds,* has adopted an approach which is completely rigid and inflexible. There the Commission finds that low-cost advantage should be preserved by establishing as the floor for one mode's reduced rates the "fully-distributed costs" of another. This floor, which is in no way oriented to the efficient utilization of the nation's transportation resources, in no sense mindful of the "circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable," or considerate of the admonition that "rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation," [38] imposes upon one mode an artificial and rigid floor reflecting the characteristics and nature of the transportation provided by another mode. The claimed right to impose such a rigid floor, diametrically opposed to the most elementary teachings of economics [39] and detrimental to the benefits of competition in the form of lower transportation charges, seems a most curious basis for an argument that the Commission's flexibility is impaired by the holding of the court below.

There is one feature of the rejection of "fully-distributed cost" floors by the Congress in 1940 which should not be overlooked. The Commission itself, through Chairman Eastman, advised the Congress that it was opposed to such floors:

> In our judgment, the provision in question [i.e., the use of fully-distributed cost floors] is not necessary in order that the public at large may enjoy the benefit and economy afforded by each type of transportation. The

38. Section 15a(3) contains these as specific standards; A. 34.
39. See A. 89-95.

> requirement in the rate-making rule that the Commission give due consideration to the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed and also to the need in the public interest of adequate and efficient transportation by such carrier or carriers at the lowest cost consistent with the furnishing of such service, coupled with the admonition in the declaration of policy in section 1 that the provisions of the act be so administered as to recognize and preserve the inherent advantages of each mode of transportation, will afford adequate protection in this respect. If experience should show that further protection is needed, contrary to our expectation, Congress can amend the act, but such a restriction as is now proposed is, we believe, both unnecessary and undesirable.[40]

Later in *New Automobiles,* when specifically confronted with a demand that a "fully-distributed cost" floor be established to preserve inherent advantages, the Commission, relying upon the legislative history of the Transportation Act of 1940, reaffirmed its views taken before the Congress and concluded that if reduced rates were compensatory they afforded all of the protection for inherent advantages which is economically justified.

(3) The Contention of the Appellants That the Interpretation of Section 15a(3) by the Court Below Is Tantamount to the Three Shall-Nots Is Misconceived.

The appellants contend[41] that the interpretation of Section 15a(3) by the court below results in the establish-

40. 86 Cong. Rec. 10191 (1940).

41. Briefs of Commission at 37-40; American Commercial Lines at 23-29.

ment of the three shall-nots[42] doctrine which was rejected by the Congressional committees.

As this Court noted in *New Haven*, the language of Section 15a(3) was the product of compromise.[43] The railroads, the principal victims of the Commission's protective and paternalistic actions, urged the enactment of legislation drafted by the Secretary of Commerce which would have compelled the Commission, in judging the lawfulness of reduced rates, to do so entirely from the standpoint of the proponent mode and without regard to the impact of such reductions upon another mode. By contrast, the other modes suggested rigid rules which would have established the proponent mode's own "fully-distributed costs" as the floor for its reduced rates.[44] While the committees did not spell out their reasons for rejecting the three shall-nots proposal, Senator Lausche, referred to as "one of the knowledgeable members of the committee in the

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42. The "three shall-nots" bill was drafted by the Secretary of Commerce and introduced in 1955 as H.R. 6141, 84th Cong., 2d. Sess. It provided that in determining whether a rate is less than a reasonable minimum, the Commission:

> . . . shall not consider the effect of such charge on the traffic of any other mode of transportation; or the relation of such charge to the charge of any other mode of transportation; or whether such charge is lower than necessary to meet the competition of any other mode of transportation. . . .

This proposal was supported by the railroads. See *Hearings On H.R. 6141 before Subcommittee on Transportation and Communications of House Interstate and Foreign Commerce Committee*, 84th Cong., 2d Sess., at 532, 537, 540, 548 (1956), and New Haven, 372 U.S. at 753.

43. 372 U.S. at 753-755.

44. See, *e.g.*, Statements of John L. Weller and James F. Pinkney, *Hearings on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce*, 85th Cong., 2d Sess., at 26, 79-81 (1958); Statements of John O. Innes and James F. Pinkney, *Hearings on Railroad Problems Before a Subcommittee of the House Committee on Interstate and Foreign Commerce*, 85th Cong., 2d Sess., at 152, 310-322 (1958).

field of transportation,"[45] did make it plain that the extreme positions of the other modes seeking "fully-distributed cost" floors were completely unacceptable. He said, "the proposal which you made, if adopted, would completely negative the purpose and intent of the Congress in 1940 and 1935 when it decided that the inherent advantages of each mode of transportation shall be preserved in the interest of the public."[46]

As this Court in *New Haven* found, the desire of Congress was to "permit each mode to assert its 'inherent advantages whether they be of service or of cost,' " and "to permit the railroads to respond to competition by asserting whatever inherent advantages of cost and service they possess."[47]

There were a great many expressions by Senators and Congressmen that these aims would be accomplished by allowing reduced rates, provided they would be compensatory. For example, Congressman Wolverton, a member of the House Commerce Committee in 1958, who had been one of the Managers of the Transportation Act of 1940, said:

> It seems to me, Mr. Langdon, that there is some merit in the point which you have made, that if each mode of transportation is permitted to have rates not below a compensatory figure so that completion can really exist, I think you are then preserving the rights, the inherent rights of each.[48]

Congressman Allen stated that Section 15a(3):

> . . . is designed to promote healthy rate competition between the different forms of carriage. . . . It would

45. 104 Cong. Rec. 10841 (1958).
46. *Hearings on S. 3778, supra,* n. 44 at 26.
47. 372 U.S. at 756, 757.
48. *Hearings on Railroad Problems, supra,* n. 44 at 409.

give carriers greater free play in establishing reduced rates if those rates are compensatory and do not discriminate unjustly among shippers.

In response to a question whether it would be possible under Section 15a(3) for one type of carrier to lower its rate to such an extent that another carrier would not be able to compete, Congressman O'Hara, another member of the House Commerce Committee, answered:

> I think the language is rather plain and means exactly what it says; that is if that particular mode of transportation has a compensatory rate and it is lower than that of the competitior, the Interstate Commerce Commission would have to allow that competing form of transportation to charge a lower rate. Does that answer the gentleman's question? [49]

Senator Smathers stated:

> . . . we are trying . . . to get the Commission away from a practice it has fallen into in the past five years, where [in] certain of these cases . . . they have said that even though a [proposed] rate would be compensatory, even though it would return a profit, and so on, we [the Commission] are not going to let them lower the rate because in [doing so] they would injure another mode of transportation with the result that we have high prices, for these articles, fixed usually on what would amount in that particular instance to the less competent mode of transportation. So the public gets hurt in that particular situation was our belief. (Brackets added for clarification.) [50]

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49. 104 Cong. Rec. 12524, 12536 (1958).

50. *Hearings on S. 3778, supra,* n. 44 at 111.

Senators Schoeppel and Lausche, both members of the Senate Commerce Committee, likewise indicated that compensatory rates should not be prohibited.[51]

Unlike the three shall-nots, which would have denied power to the Commission in judging the lawfulness of reduced rates to consider their impact upon another mode, the Congressional committees kept intact power in the Commission to outlaw reduced pricing if it constitutes an unfair or destructive competitive practice. As the House Committee Report stated:

> The committee believes that each mode of transportation should have opportunity to make rates reflecting the different inherent advantages each has to offer so that the public may exercise its choice among them, cost and service both considered, in the light of the kind of transportation desire[d]. The committee believes, however, and the national transportation policy is clear, that such ratemaking should be regulated by the Commission to prevent unfair destructive practices on the part of any carrier or group of carriers.[52]

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51. *Id.* at 10, 56. The colloquy between Senator Schoeppel and former Senator Wheeler, who was one of the managers of the Transportation Act of 1940 and who had introduced the Motor Carrier Act of 1935, is particularly significant:

> SENATOR SCHOEPPEL: Senator Wheeler, you are giving us here the congressional or senatorial intent?
>
> MR. WHEELER: That is right.
>
> SENATOR SCHOEPPEL: Of course, all of that was tied to one cardinal factor; namely, that those rates, when they were established, should be compensatory, was it not?
>
> MR. WHEELER: Exactly. As long as they were compensatory, then they could reduce the rates. The water carriers could reduce their rates as long as they were compensatory to take business away, or the motor carriers could reduce their rate to a compensatory level to take business away from the railroads, and the railroads could reduce their rates to meet the competition, as long as their rates were compensatory.

52. H. Rep. No. 1922, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 13-14 (1958).

The Commission therefore has ample power to prevent reduced pricing which constitutes an unfair or destructive competitive practice. While such practices are not defined in the legislative history, the courts have sustained the power of the Commission to disapprove reduced rates, even though compensatory, if they incorporate exclusive dealing arrangements which exclude another mode from competing.[53] The power of the Commission to condemn reduced rates specifically aimed at destroying a competitor has also been sustained, even though there is no contention that such rates are noncompensatory.[54] And it has been held that a reduction, although compensatory, which is harmful or detrimental to the proponent mode's own revenue requirements, can be found unlawful by the Commission.[55] The power to outlaw noncompensatory rates is, of course, well established by the courts[56] and recognized by the Commission.[57]

The appellants, rely upon the colloquy between Commissioner Freas and the Senate Committee,[58] which was referred to by this Court,[59] as support for their contention

53. See New York Central R.R. v. United States, 194 F. Supp. 947, 951 (S.D. N.Y. 1961), aff'd *per curiam*, 368 U.S. 349 (1962).

54. See Luckenbach Steamship Co. v. United States, 179 F. Supp. 605, 612-614 (D. Del. 1959), aff'd *per curiam*, 364 U.S. 280 (1960).

55. See Atlantic Coast Line R.R. v. United States, 209 F. Supp. 157, 159-160 (S. D. Fla. 1962). See also Tractors—T.L. & W.T.L. Territories, to S.W. & W.T.L. Ter., 319 I.C.C. 758, 765 (1963).

56. See Middlewest Motor Freight Bureau v. United States, 234 F. Supp. 151, 153-154 (D. Minn. 1964); Missouri Pac. R.R. v. United States, 203 F. Supp. 629, 635 (E.D. Mo. 1962); New York, N.H. & Hartford R. R. v. United States, 199 F. Supp. 635, 646 (D. Conn. 1961); Boston and Maine R.R. v. United States, 153 F. Supp. 952, 960 (D. Mass. 1957).

57. See Aluminum Ingots, Kansas City, Mo., to Fort Wayne, Ind., 326 I.C.C. 1, 5 (1965).

58. Brief of American Commercial Lines at 27-29.

59. 372 U.S. at 755.

that the rejection of the three-shall-nots condemns the interpretation of the court below and supports the Commission's use of "fully-distributed cost" floors in *Ingot Molds*. If there is any residual persuasion in this colloquy after the explicit Congressional directive to adhere to the philosophy of *New Automobiles*, it is dispelled by Commissioner Freas' own statements. He was Chairman of Division 2 of the Commission, which was first called upon to determine the lawfulness of ingot molds rate. In the Division's Report, the ultimate conclusion was:

> In the circumstances presented, we find for the encouragement of lawful competition and conclude that the proposed rate [ingot molds] is just and reasonable, and, consistent with the Court's [the Supreme Court's] evaluation of Section 15a(3) in the *New Haven case*, not destructively competitive.[60]

And in dissenting to the Commission's report, which found the reduced ingot molds rate unlawful, Commissioner Freas said:

> To limit a proposed reduction in rate to the fully-distributed level of another mode, regardless of the level of the other mode's rate or of other transportation circumstances, is patently anti-competitive. It must be determined whether there is room for reasonable competition. The writer so testified on behalf of the Commission in hearings which ultimately culminated in the passage of Section 15a(3).[61]

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60. 323 I.C.C. at 765, A. 44.

61. 326 I.C.C. at 88; A. 76. Commissioner Tierney, who also dissented, said:

> The majority's action herein, utilizing arbitrarily the fully distributed cost level of the low-cost mode as a floor below which the high-cost mode cannot go in establishing a competitive rate on a compensatory basis, in my opinion is contrary to the legislative history of Section 15a(3) (326 I.C.C. at 91; A. 79-80).

(4) The Legislative Histories of the Transportation Act of 1920 and the Motor Carrier Act of 1935 Sustain the Statutory Interpretation of the Court Below.

The Commission, in its brief, reviews the legislative histories of the Transportation Act of 1920 [62] and the Motor Carrier Act of 1935.[63] While the relevance of these efforts may be questionable, the conclusions reached buttress the statutory interpretation of the court below. For example, the Commission says that the Congress, in enacting the Transportation Act of 1920, indicated that a reduced rail rate, to meet water competition, should only be permitted if it would "cover and more than cover the extra expenses in handling the traffic to which it applies.[64] This is simply another way of saying that the reduced rate will be lawful if it exceeds the out-of-pocket expense of providing the service. This is precisely the interpretation of Section 15a(3) by the court below, and therefore the legislative history of the Transportation Act of 1920, to the extent relevant, supports that interpretation.

Turning to the legislative history of the Motor Carrier Act of 1935, the Commission's conclusion regarding its significance in the area of preserving inherent advantages is found on page 30 of its Brief. There the Commission says:

> Similarly, the Committee changed the rate-making section to refer to "inherent advantages" in order to "require the Commission to fix truck rates on a basis that, so far as possible, reflect the costs and advantages of motor service . . ."[65] This purpose of the phrase

62. 41 Stat. 456-500; Brief of Commission at 24-27.
63. 49 Stat. 543-567; Brief of Commission at 27-30.
64. Brief of Commission at 25.
65. 79 Cong. Rec. 5656 (1935).

> received a new impetus in the Transportation Act of 1940, . . . when for the first time it applied to all modes of transportation.

This argument of the Commission here, provides an additional basis for the position of the court below, that Congress, where expressing a concern with the preservation of inherent advantages, has indicated that from the standpoint of costs, the lawfulness of reduced rates should be judged with the proponent mode's own costs in mind. Since this is so, it follows that normally inherent advantages will be preserved if the reduced pricing exceeds such mode's own out-of-pocket cost level. To require a reduction, as the Commission did in *Ingot Molds,* to reflect the "fully-distributed cost" of a mode other than the proponent categorically contradicts the Commission's arguments to this Court respecting the legislative histories of the Motor Carrier Act of 1935 and the Transportation Act of 1940.

The legislative histories of the several Congressional enactments concerned with intermodal competitve ratemaking are very extensive and contain cross currents and views which may be somewhat difficult to reconcile, but their main theme stands out boldly. The desire of the Congress has been to give each mode freedom to respond to the urgings of competition by reducing the prices of its services to reflect its own cost characteristics and thus pass along the benefits of the resulting lower transportation charges to the public. The one overall controlling guideline is the expressed intention of Congress that by enacting Section 15a(3) the philosophy of *New Automobiles* would be imple-

mented.[66] As explained before, *supra*, 16 to 20, the interpretation of the court below is fully consistent with the philosophy of *New Automobiles*, and, what is of at least equal importance from the standpoint of the instant litigation, the Commission's conclusion condemning the ingot molds rate is patently incompatible with that philosophy and is therefore, as the court below held, not in accordance with law.

B. The Court Below Was Right in Holding That the Commission's Efforts to Recognize and Preserve Inherent Advantages Lack a Rational Basis and Therefore Are Arbitrary

None of the Appellants questions the soundness of the proposition stated by the court below—that if the Commission's efforts to recognize and preserve inherent advantages lack a rational basis they are arbitrary within the meaning of the Administrative Procedure Act, and should be set aside,[67] but the conclusion of the court [68]

66. S. Rep. No. 1647, *Transportation Act of 1958*, 85th Cong., 2d Sess. (1958). The Senate Committee, in adopting the views of its subcommittee, stated at page 3:

> The subcommittee wishes to affirm the interpretation of the Commission given in the Automobile case epitomized in the words quoted above. The subcommittee therefore believes it necessary to amend the act only so as, in effect, to admonish the Commission to be consistent in following the policy enunciated in the Automobile case thus assuring reasonable freedom in the making of competitive rates. * * *
>
> The subcommittee anticipates that the broad effect of this amendment will be to encourage competition between the different modes of transportation to the benefit of the shipping public. * * *

The House Committee Report is to the same effect. H. Rep. No. 1922, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 14-15 (1958).

67. 268 F. Supp. at 75—quoting Section 10(b) of the Administrative Procedure Act and supporting cases, A. 16.

68. *Idem.*

that the rational basis does not exist is disputed.[69]

This Court, in *New Haven,* left unresolved the questions of how inherent advantages should be recognized and preserved, as required by the National Transportation Policy, which is an integral part of Section 15a(3).[70] The initial resolution of these questions was left to the Commission's judgment. Implicit in this assignment was the thought that the Commission would make a thorough and careful study of the matter and spell out in detail, and with precision, the reasons and justifications for its conclusions. Both in view of what this Court had done in *New Haven* and the importance of the questions to the transportation industry, *Ingot Molds*—which the Commission recognized was a proper vehicle to resolve the questions[71] —far more than the ordinary case, demanded a well articulated, logical and rational basis for the determinations reached. It is not there. This is made plain first, by the decision of the court below; and second, by the efforts of the appellants to fill the vacuum by a late conceived theory, which is unsound, and was neither discussed by the Commission nor used as a basis for its decision.

Since the National Transportation Policy, in addition to requiring the Commission to recognize and preserve inherent advantages, also instructs the agency to "foster sound economic conditions in transportation and among the several carriers," the railroads, in defending the ingot molds rate, presented testimony describing the economic principles applicable to price reductions in competitive situations. This testimony, which was not refuted, demonstrates that adherence to these principles will insure the

69. Briefs of Commission at 40-50; American Commercial Lines at 39-51; American Trucking Associations at 20-24; and American Waterways Operators at 12-16.

70. 372 U.S. at 760-761.

71. 326 I.C.C. at 80; A. 65.

recognition and preservation of the inherent advantages of the several modes of transportation and will result in the most efficient utilization of the nation's transportation resources.[72]

Briefly, it is elementary economics that in determining the wisdom of making a pricing reduction of an individual service to respond to competition, the only relevant cost is incremental cost or, as that term is used here, out-of-pocket cost. This is the added expense incurred in producing the particular service. With this cost as the floor, the price is established upwards from it so that the excess of revenues above such cost is maximized. The achievement of this objective depends primarily upon demand considerations. If the demand for the particular service is strong, as it will be if attractive alternative competitive services are not present, a price considerably above the out-of-pocket cost floor can be charged. But where competition is intense and attractive alternate services exist, a price fairly close to the out-of-pocket floor must be established to generate traffic. Where the aggregate revenues above the out-of-pocket cost floor are maximum because the price is properly responsive to the competitive situation, the enterprise can do no better.[73]

It is the revenues above the out-of-pocket cost floor which are used to meet the enterprise's constant expenses. Thus, the recovery of the total constant expenses is dependent upon the application of the principles just described.

It is a characteristic of the railroad industry that many individual services which make substantial contributions to the railroads' constant expenses are those which have rates quite close to the out-of-pocket cost level. Typi-

72. This testimony was offered by four distinguished economists and is set forth in full in the appendix, A. 81-160.

73. A. 86-87.

cal examples are bulk commodities, such as coal and iron ore, which move in large volumes.[74]

Fully-distributed cost related to a particular item of traffic, as explained before,[75] is a combination of out-of-pocket expenses plus an arbitrary assignment of a portion of the constant expenses. Because of this, it cannot be used intelligently as a floor for reduced competitive pricing. Such a floor is artificially inflated and, in a large number of instances, will rule out many rates below it which must be established at such levels to effectively compete. These rates, by attracting or holding business, would produce revenues above the expenses of providing the service, *i.e.*, the out-of-pocket costs and, therefore, would make contributions toward the constant expenses. Thus, the use of "fully-distributed cost" floors in competitive situations will destroy opportunities to recover constant expenses.[76]

Where the concern is with the determination of which of two competitive modes is the more efficient, or has the advantage of lower costs, in providing a particular competitive service, a comparison of out-of-pocket costs is the only one that may be sensibly made, since such costs represent the expenses each mode actually incurs in performing that service.[77] For such purpose a comparison of "fully-distributed costs" cannot be justified.

While the recognition of which of two modes has the inherent advantage of lower costs may have importance, of more crucial concern is the preservation of low-cost advantage. From the standpoint of elementary and fundamental economics, the inherent advantage of lower costs, or su-

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74. A. 141.
75. *Supra*, at 5.
76. A. 89-98, 111-115, 123-129, 134-136, 147-148.
77. A. 114, 134-135.

perior efficiency, is preserved if the out-of-pocket costs of the proponent mode are established as the floor for—not the level of—reduced carrier pricing. Such a floor permits the carrier to establish pricing which will be properly responsive to demand and competitive circumstances and at the same time prevents below-cost pricing which is destructive to the proponent and harmful to the competitor. Thus, the out-of-pocket floor permits each mode to reflect its own cost characteristics and to thereby assert whatever advantages of low cost it may possess. Further, and more important from the standpoint of the public interest, such a floor promotes the most efficient use of the nation's transportation resources and affords the shipping public the lowest transportation rates commensurate with reasonable carrier prosperity.[78]

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78. That these economic principles are widely held and generally regarded as both elementary and fundamental has ample support. For example, the ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS (1966) in reporting to the President said:

> For maximum economic efficiency, rates should be related to costs, but not to an arbitrary allocation of costs. Railroads and pipelines require large, indivisible capital inputs such as rights-of-way and terminals. These indivisibilities result in relatively high fixed costs, which, if allocated over each traffic unit on an arbitrary basis, result in average costs unrelated to the variable expenses of additional traffic. These average costs do not and cannot serve as a rigid basis for rate making.
>
> "Cost-oriented rates" in the true economic sense are related to the economist's concept of marginal cost—the increase in total expenses as a result of carrying additional ton-miles of traffic. In order to ensure efficiency, marginal, rather than average, cost should be the principal regulatory criterion in applications for rate reductions (*Id.* at 126).

In the Economic Report of the President, transmitted to the Congress in January 1966, the recommendations of the Council are endorsed and characterized at page 12 as guideposts for noninflationary wage and price behavior.

The views of the Council are virtually identical to those earlier expressed in the REPORT OF THE ROYAL COMMISSION ON CANADA'S ECONOMIC PROSPECTS (1957):

Application of the economic principles just discussed to the ingot molds rate compels the conclusion that the Commission should have approved it. The Commission found that for handling this particular traffic "The railroads' out-of-pocket costs are lower than the barge-motor lines variable costs." [79] In view of this finding, the railroads, without incurring a loss, have the ability to price their service at lower levels than the barge-truck route. And with respect to such ability, what this Court said in *Schaffer Transp. Co. v. United States*, 355 U.S. 83, has special significance:

> The ability of one mode of transportation to operate with a rate lower than competing types of transportation is precisely the sort of "inherent advantage" that the congressional policy requires the Commission to recognize. (*Id.* at 91) [80]

Actually, the railroads have not exploited their advantage since they have not undercut the barge-truck price but merely equaled it, thereby giving the shipper a choice of two competitive services at the same price. The ingot molds rate is not detrimental to the railroads' own revenue needs, but is in fact constructive because it provides increased contributions to their constant costs.[81] And

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Of course, any traffic which meets its long-run out-of-pocket costs and makes some contribution to common overheads, no matter how small, should be carried by the carrier concerned; in this way overheads on the remaining traffic are reduced, all shippers are better off, and the most efficient use of transport resources is promoted (*Id.* at 274).

79. 326 I.C.C. at 84; A. 71.

80. The reports of the Senate House Committees in 1958 cited this case and particular quotation with approval in their comments recommending the adoption of Section 15a(3). S. Rep. No. 1647, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 3 (1958); H. Rep. No. 1922, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 13-15 (1958).

81. 323 I.C.C. at 763-764; A. 42.

the approval of the rate would leave intact, and therefore preserve, whatever inherent advantage is possessed by the barge-truck route. Such service is still completely free to adjust its price to reflect its own cost characteristics.[82]

While Division 2 notes in passing that the testimony relating to the economic principles was before it,[83] at no point in its report is there any adequate explanation as to why the principles should not be followed. The only stated basis for ignoring the economic principles is that ". . . we [the Division] recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced here by . . . [the railroads] ignores them."[84] This conclusion of Division 2 totally disregards and repudiates the teaching of the economic principles that the out-of-pocket cost floor, with pricing established above it which is responsive to demand considerations, is not only the best way to meet constant expenses but, in virtually every instance, the only way. The Commission, in its Report, does not even mention the economic principles.

As explained by the court below, the Commission "was not bound to accept" the economic testimony, but its presence did "make it necessary for the Commission to set forth adequate reasons to support its own approach,"[85] which was completely to the contrary. See *Chicago Junction* case, 264 U.S. 258, 265; *Schaffer Transp. Co. v. United States*, 355 U.S. 83, 91-92.

The court below quotes in full the reasons given by the Commission for using a comparison of "fully-distributed costs" for the recognition of low-cost advantage,[86] and ex-

82. 323 I.C.C. at 764; A. 42-43.
83. 323 I.C.C. at 761; A. 39-40.
84. 323 I.C.C. at 763; A. 41.
85. 268 F. Supp. at 77; A. 20.
86. 268 F. Supp. at 76; A. 18-19.

plains why they are completely inadequate. The unanswered question, as the court below says, is why one mode which has lower out-of-pocket costs in performing a particular service, assuming these costs include all of the expenses of providing that service, is not more efficient than another mode whose out-of-pocket costs of furnishing a comparable service are higher.

The Commission's reference to the *Southern Grain* case [87] for using "fully-distributed cost" comparisons to determine the existence of inherent advantages is wholly without logic, for in that case the Commission concluded that where water carriage is unregulated—which the court below might have added is the predominant situation [88]—reduced rail rates to meet such competition should be permitted if they exceed "the proponent carrier's out-of-pocket costs." [89] Unregulated water transportation operates lawfully and comprises an important part of the nation's transportation system, and therefore, if such policy is economically sound where railroads are competing with unregulated water carriers, it should be equally so where the competition is regulated. To reach a different conclusion requires an assumption that because the competition is regulated its traffic is entitled to artificial protection from otherwise fair competition. But such an assumption would be without basis in view of what this Court said in *New Haven*:

> The mood of Congress was perhaps best summarized by Senator Smathers when he said:

87. 268 F. Supp. at 77; A. 21.

88. 80TH ANNUAL REPORT OF INTERSTATE COMMERCE COMMISSION at 147 (1967). Almost 90 percent of the intercity ton-miles by water carriage are not federally regulated. For motor carriage the nonregulated figure is 65 percent.

89. 268 F. Supp. at 77; A. 21.

> "[W]e are going to eliminate some of the paternalism which has heretofore existed in the minds of the Interstate Commerce Commission. I think we will breathe into our whole system of transportation some new competition, which of course is needed, because the public and the consumer will benefit therefrom." [90]

The appellants also argue that the court below erred in holding that the required rationale was not supplied by the Commission's reliance upon its own earlier cases.[91] While it is well established that the Commission may look to its earlier cases as a basis for decision, this may only be properly done if such cases themselves contain an adequate rationale and represent a consistently applied standard. See *T.I.M.E. v. United States*, 359 U.S. 464, 476.[92] In the opinion of the court below, there are listed several Commission cases in which the "fully-distributed cost" approach of *Ingot Molds* was not used, and rates which were reduced because of intermodal competition were approved on the basis they exceeded the proponent mode's own out-of-pocket costs.[93] In addition to the cases listed and the one quoted from, the court below could have included a very large number of cases to the same effect. A typical example would be *Aluminum From Kansas City to Illinois and Wisconsin*, 321 I.C.C. 432 (1963), where a motor carrier

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90. 372 U.S. at 757.

91. See *e.g.*, briefs of American Commercial Lines at 43; American Trucking Associations at 21.

92. See also County of Marin v. United States, 356 U.S. 412, 420; New York Central Railroad v. United States, 267 F. Supp. 619, 624-625 (S.D. N.Y. 1967). Cases cited by appellants for the proposition that the Commission correctly relied upon its earlier decisions, such as Simpson v. United States, 200 F. Supp. 372 (S.D. Iowa 1961) and Nowinsky Trucking Company v. United States, 195 F. Supp. 748 (W.D. Wis. 1961) are not in point because each assumes that the earlier decisions relied upon supply the required rational basis. 200 F. Supp. at 377 and 195 F. Supp. at 751.

93. 268 F. Supp. at 78; A. 22.

reduced its rate on aluminum ingots to 61.5 cents, thus equalizing the rail rate. The railroads protested this reduction claiming it was noncompensatory. Finding the reduced rate exceeded the motor carrier's out-of-pocket costs by a mere 2.6 cents, the Commission approved it saying:

> The proposed rate now appears to be reasonably compensatory. It is a matter of record that a rate on the level of the competitive rail rate, is the highest the shipper will pay for motor carrier service. In these circumstances the proposal is deemed justified. *Id.* at 433.

A mere reading of the cases cited by the Commission in its Report will make it abundantly plain that none contains a rationale for using a comparison of "fully-distributed costs" to determine the existence of low-cost advantage.[94]

Some of the appellants take the position[95] that the Commission's reference to *New Haven* supplies a rational basis for comparing "fully-distributed costs" to determine low-cost advantage. This Court did say in *New Haven* that the problem of how inherent advantages should be recognized and preserved in a situation like *Ingot Molds* led to the incorporation of the National Transportation

94. 326 I.C.C. at 83-84; A. 70. [illegible] Electric Cable & Wire, Worcester, Mass., to Houston, Tex., [illegible] I.C.C. 390 (1963), is a three-page report and order which is totally devoid of any discussion as to why "fully-distributed costs" should be the measure rather than incremental costs. Plastics From Texas to the East, 319 I.C.C. 379 (1963) is similarly devoid of such discussion. In Frozen Juice & Fruit From Florida to the North, 319 I.C.C. 577 (1963), the Commission was unable to determine which mode had the lower costs; and in Candy & Confectionery From N.J., N.Y. & Pa. to Tex., 321 I.C.C. 154 (1963), there was no real concern with the measure of low-cost advantage. And what is most significant in all four of these cases, the ultimate finding was that the reduced rail rates were lawful.

95. Briefs of American Commercial Lines at 46-47; American Trucking Associations at 17-20.

Policy in Section 15a(3).[96] But, as noted by the court below, in *New Haven,* this Court in the clearest language held that the problem was not before it and that it was neither addressing itself to the problem nor recommending a solution. Rather, the solution was initially to come from the Commission after being considered in an appropriate proceeding.[97] The court below therefore correctly held that the Commission's looking to *New Haven* for support was futile.[98]

One of the most astounding features of the Commission's Report is its treatment of the second aspect of the inherent advantages problem. Certainly of at least equal importance to the recognition of which mode has the inherent advantage of lower costs is the means taken to preserve such advantage with whatever mode may possess it. The Commission disposes of this in a single, very short paragraph containing: first, a naked conclusion; second, a complete *non sequitur,* and third, citations to cases of this Court which have no relevance whatsoever to the problem and were decided before the enactment of Section 15a(3).[99] Without the support of any economic principle

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96. 372 U.S. at 758-759.

97. 372 U.S. at 749-750, 760.

98. 268 F. Supp. at 78; A. 22-23.

99. The court below, 268 F. Supp. at 79; A. 24, quotes the paragraph which reads:

> In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. *Cf.* Interstate Commerce Commission v. Mechling, 330 U.S. 567, 575-579, 67 S.Ct. 894, 91 L.Ed. 1102 (1947); Dixie Carriers, Inc. v. United States, 351 U.S. 56, 76 S.Ct. 578, 100 L.Ed. 934 (1956).

or theory and without any explanation whatsoever of why it is doing so, the Commission says that the inherent advantage should be preserved by establishing, as the floor for the proponent mode's reduced pricing, the "fully-distributed cost" level of another mode.[100] It is not surprising that Commissioner Freas, in dissenting, was persuaded to say:

> In light of the arbitrary aspects of fully distributed costs, I find it hard to square the majority's cavalier acceptance of those costs as a pricing floor with more relaxed and, to an extent, incremental, standards of other formulas.[101]

The language used by the court below in holding that a rationale is wholly lacking for this conclusion of the Commission speaks tersely and convincingly. There would appear to be no reason to argue the point further.[102]

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100. 326 I.C.C. at 85; A. 71.

101. 326 I.C.C. at 87; A. 74.

102. Throughout the briefs of the corporate appellants, there are allegations to the effect that the opinion of the court below will enable the railroads to destroy their intermodal competitors, *e.g.*, Briefs of American Commercial Lines, at 16, 19, 57, 59; American Trucking Associations, at 7; and American Waterways Operators at 17-18, and at one point the extravagant claim is made that the railroads "have deliberately selected a rule of law which would let them destroy low-cost water carriers rather than compete with them." A short answer to these false and misleading allegations is the total absence of any findings by the Commission that the ingot molds reduction is predatory, or maliciously conceived.

A further answer is, although the majority of rail rates are below fully-distributed cost levels, such pricing has in no way impaired the phenomenal growth of the barge and motor truck carriers. There was incontroverted evidence to this effect before the Commission in Ingot Molds. Exhibit No. 42 [not printed in the appendix] shows since 1958, the date of the enactment of Section 15a(3), intercity truck traffic has increased over 35 percent, and barge traffic over 27 percent, while rail traffic has had only a modest increase of 14 percent. These figures have particular significance in view of the earlier claim made in 1933 by Mississippi Valley Barge Co.—one of the more important appellants here—that certain reduced rail rates "high enough

(1) The Efforts of the Appellants to Supply the Rational Basis Lacking in the Commission's Reports Must Fail

A side by side reading of the Report of the Commission and the briefs of the appellants on the issue of whether the Report contains a rational basis for the determinations reached, leaves a strong feeling that the appellants themselves lack confidence in the Commission's efforts and that therefore they must do what the Commission could not do—supply a rationale. Each of the briefs contains a great deal of argument, none of which was articulated or relied upon by the Commission in its Report. The chief thrust of these attempted *post hoc* rationalizations is spelled out in the Commission's brief which goes to great lengths to show that a comparison of "fully-distributed costs" is the only way to give recognition to the fact that the water carriers and motor carriers have the natural advantage of access to Government supplied rights-of-way at little or no cost, and by contrast the railroads must pay for their rights-of-way out of their own pockets.[103] The other appellants advance the same proposition.[104]

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to pay more than the cost of service" were unlawful. Mississippi Valley Barge Co., in support of its claim said ". . . it is fighting for its life, and that the effect of the new competition will be to drive it out of business . . . [and] if respondents succeed, the barge lines will be dealt a staggering blow." These contentions were readily disposed of by this Court in Mississippi Valley Barge Co. v. United States, 292 U.S. 282. In sustaining the Commission's order which had found rail reduced rates lawful, this Court held that the railroads should not "be required to maintain a rate that is too high for fear that through the change they may cut into the profits of carriers by water" in the absence of a showing that the reductions were "in circumstances of wanton or malicious injury." (*Id.* at 288, 289)

103. Brief of Commission at 46-50.

104. Briefs of American Commercial Lines at 44-48; American Waterways Operators at 12-14.

Nowhere in either of the Reports of Division 2 or the Commission is there a single word having anything to do with whether Government supplied rights-of-way for water and motor carriers constitute an inherent or natural advantage. And this is equally so as to whether "fully-distributed costs" should be used to measure the windfall. In view of this, these late supplied rationalizations cannot aid the appellants here. As this Court said in *Burlington Truck Lines v. United States,* 371 U.S. 156, 168-169:

> The courts may not accept appellate counsel's *post hoc* rationalizations for agency action; *Chenery* requires that an agency's discretionary order be upheld, if at all, on the same basis articulated in the order by the agency itself. . . .

But assuming *arguendo* only, these attempted rationalizations can be properly advanced by the appellants here, they are nevertheless in substance fatally deficient.

The costs of Government in supplying waterways, canals and navigation improvements, which are made available without any user charges to the water carriers for the pursuit of their commercial activities; and the costs of Government in supplying the magnificent national highway system abundantly used by the motor carriers, which are not covered by adequate user charges, in no way are included or reflected in the water carrier or motor carrier costs when computed by the Commission's applicable formulas. No such costs were assessed against the barge-truck route in *Ingot Molds.* This is true regardless of whether the costs are computed on an out-of-pocket or fully-distributed basis.

By contrast the railroads' out-of-pocket expenses, as computed by Rail Form A—as was done in *Ingot Molds*—include all of the right-of-way expenses which are regarded

as being incurred by the particular service being costed, for example, they include large amounts of the expenses occasioned by maintenance and construction of roadway property plus 50 percent of the return on the depreciated value of all roadway property.[105] This being true, a comparison of the two modes' out-of-pocket costs to determine low-cost advantage gives full cognizance to the fact that water motor carriers have the use of free roadways and that the railroads have to pay for theirs.[106]

But more importantly, if the proponent mode's own cost characteristics are to determine from the cost standpoint the lawfulness of its rate reductions, it follows that the establishment of the proponent mode's out-of-pocket costs as the floor will both recognize and preserve the advantage the water and motor carriers enjoy from the availability of Government supplied rights-of-way. This must be so because the costs of such facilities are not included in these modes' out-of-pocket costs. And the corollary is equally true. The use of the railroads' out-of-pocket costs, which include the variable portion of roadway expenses, as a floor for reduced rail rates, will give recognition to the fact that the railroads have the disability of paying for their rights-of-way.

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105. See EXPLANATION OF RAIL COST FINDING PROCEDURES AND PRINCIPLES RELATING TO THE USE OF COSTS—I.C.C. COST FINDING SECTION STATEMENT No. 7-63 at 58, 60, 86 (1963). The costs, as computed by Rail Form A in Ingot Molds, are not in dispute here nor were they in the court below.

106. The Economic testimony made the point that any comparison of "fully-distributed costs" to determine low-cost advantage would be unsound because such comparison does not give recognition to the fact that included in the costs of furnishing barge and truck services are the costs borne by the Gover..ment. See A. 89-91; 134-135. The existence of this situation likewise distorts in favor of the barge and motor carriers a comparison of out-of-pocket costs.

It must be obvious that the position of the appellants here would superimpose upon an injustice, *i.e.*—the supplying of rights-of-way by the Government to the water and motor carriers without adequate reimbursement—the added unfairness of an anticompetitive restraint against the railroads in the form of uneconomic and artificial rate floors. While this is bad enough from the standpoint of the railroads, which would be denied the right to compete on a fair and equitable basis, and in conformity with the intentions of the Congress, it is still worse for the public, which would be deprived of the benefits of competition in the form of lower transportation charges.[107]

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107. It is significant that since the passage of Section 15a(3) in 1958, which has given the railroads a measure of pricing freedom, the level of rail freight charges has been reduced some 13 percent comparing 1965 and 1958.

V.

CONCLUSION AND RELIEF REQUESTED

For the reasons stated more fully above, it is most respectfully submitted that this Court should affirm the judgment of the court below which set aside the Report and Order of the Interstate Commerce Commission in *Ingot Molds, Pa. to Steelton, Ky.*, 376 I.C.C. 77 (1965) and enjoined the Commission from enforcing it.

Respectfully submitted,

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PROOF OF SERVICE

I, CARL HELMETAG, JR., one of the attorneys for the the Railroad appellees herein, and a member of the Bar of this Court, hereby certify that on the 10th day of April, 1968, I served copies of the Brief for Railroad Appellees on counsel for all the parties to this action as follows:

1. On the United States, by mailing copies in duly addressed envelopes:

A. With first-class postage prepaid to the Honorable Erwin N. Griswold, Solicitor General, Honorable Ramsey Clark, Attorney General, Honorable Donald F. Turner, Assistant Attorney General, Lionel Kestenbaum, Esq., and Richard Haddad, Esq., Attorneys, Department of Justice, Washington, D. C. 20530.

B. With air mail postage prepaid to the Honorable Ernest W. Rivers, United States Attorney and Honorable William B. Martin, Assistant United States Attorney, Federal Building, Room 211, Louisville, Ky. 40201.

2. On the appellant Interstate Commerce Commission, by mailing copies in duly addressed envelopes, with first-class postage prepaid to its attorneys, Honorable Robert W. Ginnane, General Counsel, Honorable Fritz R. Kahn, Associate General Counsel, Honorable Leonard S. Goodman, Associate General Counsel, Washington, D. C. 20423.

3. On the separate appellants herein, by mailing copies in duly addressed envelopes:

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CARL HELMETAG, JR.

SUPREME COURT, U. S.

Nos. 797, 804, 808, and 809

APR 13

In the Supreme Court of the United States

OCTOBER TERM, 1967

AMERICAN COMMERCIAL LINES, INC., ET AL., APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY ET AL.

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL., APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

THE AMERICAN WATERWAYS OPERATORS, INC., APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

INTERSTATE COMMERCE COMMISSION, APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR THE UNITED STATES

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ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (A. 12–32) is reported at 268 F. Supp. 71. The report of Division 2

of the Interstate Commerce Commission (A. 35–59) and the report of the entire Commission upon reconsideration (A. 60–80) appear at 323 I.C.C. 758 and 326 I.C.C. 77, respectively.

JURISDICTION

The judgment of the district court (A. 32–33) was entered May 15, 1967. Notices of appeal were filed on July 12, 13 and 14, 1967. Probable jurisdiction was noted on January 15, 1968 (389 U.S. 1032). The jurisdiction of this Court to review the judgment below on direct appeal rests upon 28 U.S.C. 1253 and 2101(b). *United States* v. *Drum,* 368 U.S. 370; *Dixie Carriers, Inc.* v. *United States,* 351 U.S. 56.

STATUTES INVOLVED

Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. 15a(3) provides:

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

The National Transportation Policy (49 U.S.C., preceding sections 1, 301, 901, and 1001) reads as follows:

> It is hereby declared to be the national trans-

portation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

QUESTION PRESENTED

Whether the Interstate Commerce Commission erroneously held that an undue impairment of the inherent advantage of a combined barge-truck service over a competing rail service had been adequately shown by comparing the fully distributed costs of the competing modes of transportation.

STATEMENT

Since 1953 the movement of ingot molds from Neville Island and Pittsburgh, Pennsylvania, to Steel-

ton, Kentucky, has been principally by combination barge-truck service, and since 1960 the overall charge has been $5.11 per ton. In 1965 the Pennsylvania Railroad and the Louisville & Nashville Railroad met the barge-truck rate by reducing their rate for transportation over the route from $11.86 to $5.11 per ton. On protest by the barge lines, joined by intervening truck interests, that the rail rate was unlawful under Section 15a(3) of the Interstate Commerce Act (49 U.S.C. 15a(3)) because it impaired or destroyed the inherent cost advantage of the barge-truck service, the Interstate Commerce Commission undertook an investigation (see A. 36–37, 61).

In the administrative proceedings which followed, the railroads presented economic evidence to show that inherent advantage should be determined by comparison of each mode of transportation's out-of-pocket costs, *i.e.*, the incremental cost incurred for carrying the particular traffic. The barge-truck interests urged that it should be determined by comparing each mode's fully distributed costs. Division 2 of the Commission found comparative cost levels (on a per-ton basis) for the two modes as follows (A. 53–59):

Rail out-of-pocket costs	468.9 cents
Rail fully-distributed costs	759.4 cents
Barge costs (including the charge to shippers for transfer and trucking services)	519.6 cents

The railroads' out-of-pocket cost was computed by application of a formula developed by the Commission's Cost Section utilizing reported operating data of each railroad for 1962 (A. 44–59). The formula includes all expenses traceable to providing the service over an intermediate long-range period, including

80 percent of total operating expenses, rents and taxes, and an allowance for return after income taxes at four percent on one-half of the depreciated investment in equipment.[1]

The rail fully-distributed cost was determined by adding to the out-of-pocket cost an allocated portion of the railroads' constant expenses, *i.e.*, those not related to particular units of service. These include costs related to bridges, rights-of-way, and excess roadway, which must be maintained regardless of traffic volume. In addition, they include railroad passenger and less-than-carload deficits.

The barge-truck fully-distributed cost was based upon figures in various reports plus the barge-to-truck transfer charge and the for-hire truck charge (App. 50–51).[2]

Division 2 of the Commission held that inherent cost advantage must be determined by a comparison of fully-distributed costs. It found, therefore, that the barge-truck service had the inherent cost advantage, but concluded that the railroads' rate reduction did not unduly impair it. In its view the reduced rate simply matched the barge-truck rate of $5.11—itself below the barge-truck fully-distributed cost of $5.19—and it concluded that under Section 15a(3) the barge-truck service could continue to compete effectively

[1] Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs., I.C.C. Cost Section Statement No. 7–63, p. 3 (1963).

[2] The Commission indicated no precise amount for barge-truck out-of-pocket cost but found that this figure was greater than railroad out-of-pocket cost (A. 71).

and still charge a rate above its out-of-pocket cost (A. 42–43).

The railroads petitioned the full Commission for reconsideration of the Division 2's determination that fully-distributed costs were the standard for determining an inherent cost advantage. The barge carriers petitioned from the Division's finding that their inherent advantage was not unduly impaired by the reduced rail rate.

The full Commission, three members dissenting, held that the rail rate unduly impaired the barge-truck mode's inherent advantage because it was lower than the barge-truck fully-distributed cost. The Commission noted that its recent practice had been to determine inherent advantage on the basis of fully-distributed costs. It rejected the railroads' economic evidence supporting an out-of-pocket cost standard on the ground that a carrier's ability to handle traffic at rates below fully-distributed cost does not necessarily mean that it is more efficient than its competitors. It also held that to depart from the fully-distributed-cost standard would not be justified, on the limited record before it, particularly since similar issues were pending before it in another proceeding (A. 60–80).

In a suit brought by the railroads, in which the United States, a statutory defendant, supported their position, a three-judge district court unanimously set aside the Commission's order (A. 32–33). In a detailed opinion it reviewed the record, analyzed this Court's opinion construing Section 15a(3) in *Interstate Commerce Comm'n* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, and considered the legislative history of

Section 15a(3) and the National Transportation Policy. It held that the Commission's decision lacked any rational basis; and that on this record the Commission's determination was inconsistent with the objectives and purposes of Congress in enacting Section 15a(3) (A. 12–32). It remanded the matter to the Commission for further action not inconsistent with its opinion (A. 32–33).

SUMMARY OF ARGUMENT

In Section 15a(3) of the Interstate Commerce Act Congress provided that "[r]ates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy * * *." Under Section 15a(3), whose history and purpose were comprehensively reviewed in *Interstate Commerce Comm'n* v. *New York N. H. & H. R. Co.*, 372 U.S. 744, a carrier may normally reduce its rates to any level compensatory in terms of its own revenue requirements, whatever the resulting diversion of traffic from competing modes. Only if the competing modes show that their inherent cost and service advantages will be unduly impaired or destroyed is this presumption rebutted. Thus, Section 15a(3) guards against preventing a carrier from asserting its inherent advantage just as it guards against the undue impairment or destruction of another mode's inherent advantage.

In the instant case, the Commission ignored these principles in concluding that the barge-truck mode had the inherent advantage over the railroads because

the latter had the highest fully-distributed cost. It gave no adequate explanation for using comparisons of fully-distributed costs as the standard for this fundamental determination. Expert testimony reflecting reputable economic thought indicated that a comparison of fully-distributed costs can never describe inherent advantage accurately, since unlike factors wholly unrelated to the traffic are necessarily involved in such figures. In contrast, utilization of out-of-pocket costs, which allocate the carriage of particular traffic to whichever mode can move it at the least additional cost, permits the market to determine inherent advantage on the basis of direct cost to the user and comparative service advantages.

Not only did the Commission fail to furnish any grounds for reqecting this testimony; it gave no sound justification for its reliance on a fully-distributed cost standard. It stated only that low out-of-pocket costs are not necessarily an indication of efficiency, that fully-distributed costs had been used in prior cases, and that in view of another pending proceeding it would not consider the matter presently. This constituted a wholly inadequate performance of the Commission's duty under *New Haven*. The Commission's apparent motive for rejecting out-of-pocket pricing was simply to protect the competing barge lines from vigorous rail competition for the traffic. This, however, is contrary to Congress's purpose in enacting Section 15a(3), as reflected in its legislative history and in *New Haven*.

The Commission's effort to furnish in this Court the rationale lacking in its decision below infringes

the principles of *Burlington Truck Lines* v. *United States*, 371 U.S. 156, and *Securities & Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194. Moreover, the premise of that rationale—that barge lines always have the inherent advantage because unlike railroads they incur no right-of-way costs—begs the question, would leave nothing for the Commission to do, would render Section 15a(3) meaningless, and would be wholly inconsistent with the *New Haven* case. As thus construed, Congress's purpose in enacting Section 15a(3) and the National Transportation Policy would be frustrated, for instead of creating vigorous intermodal competition, as Congress intended, it would leave the Commission with *carte blanche* to engage in intermodal protectionism.

ARGUMENT

THE COMMISSION ERRED IN CONCLUDING THAT AN UNDUE IMPAIRMENT OF THE INHERENT ADVANTAGE OF THE BARGE-TRUCK MODE HAD ADEQUATELY BEEN SHOWN THROUGH COMPARING THE FULLY-DISTRIBUTED COSTS OF THE COMPETING MODES

1. Ten years ago Congress added Section 15a(3) to the provisions in Part I of the Interstate Commerce Act governing railroad rate making. It provides that in proceedings involving intermodal competition, "the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable." More pertinently, the statute prescribes that "[r]ates of a carrier shall not be held up to a particular level to protect the traffic of any other mode

of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act." The National Transportation Policy, adopted in the Transportation Act of 1940 (54 Stat. 899), directs the Commission to administer the Act so as to recognize, promote or encourage certain specified economic considerations to the end of achieving a national transportation system adequate to meet the nation's postal, commercial and defense needs. One of these considerations is that the Commission is "to recognize and preserve the inherent advantages of each [mode regulated under the Act]."

In *Interstate Commerce Comm'n* v. *New York, N.H. & H.R. Co.*, 372 U.S. 744 ("the *New Haven* case"), this Court comprehensively reviewed the history and purposes of Section 15a(3) and the significance of its reference to the National Transportation Policy. It held that under Section 15a(3) reduced rates of a railroad which exceed its out-of-pocket cost but are lower than the fully distributed cost of a competing mode are lawful even if they take some or all of the traffic involved from the competing mode, *unless* the Commission (1) finds that the competing mode has the overall inherent advantage, considering comparative costs and service efficiencies, and (2) further finds that this inherent advantage would be unduly impaired or destroyed by the reduced rates. Once a carrier has established that the proposed rate is just and reasonable from the standpoint of its own revenue requirements, the burden is on the protesting carrier claiming injury to its inherent cost advantage to show that it has the overall advantage and that this ad-

vantage would be unduly impaired (*id.* at 760, 761). Noting that concepts of fully-distributed and out-of-pocket costs might prove unsatisfactory criteria in an intermodal context and that "some different measure" might be necessary, the Court further held that it was for the Commission initially to determine how to measure inherent advantage and the appropriate method of protecting it (*ibid.*).

Thus, *New Haven* made clear, as the court below held, that under Section 15a(3) a carrier should normally be free to reduce its rates to any level compensatory in terms of its own revenue requirements, whatever the resulting diversion of traffic from competing modes. Only if the competing mode shows that its inherent cost and service advantages will be unduly impaired or destroyed is this presumption rebutted.

New Haven also makes clear that inherent advantage under Section 15a(3) and the National Transportation Policy is a two-way street. It guards against intermodal protectionism which would require any carrier to maintain rates at levels which would protect competing modes from loss of traffic and thus prevent it from asserting its inherent advantage, just as much as it guards against the undue impairment or destruction of a mode's inherent advantage. As this Court, after reviewing the legislative history of Section 15a(3), pointed out, "Congress did not regard the setting of a rate at a particular level as constituting an unfair or destructive competitive practice *simply* because that rate would divert some or all of the traffic from a competing mode," but rather "made it clear that something more than even hard competition

must be shown before a particular rate can be deemed unfair or destructive" (372 U.S. at 759). The Act requires that "due consideration", not controlling weight, be given to the objectives of the National Transportation Policy. And the legislative history makes clear that all competing modes, including railroads, are entitled to assert their inherent cost advantage (see 372 U.S. at 755).

2. Implicit in *New Haven* is the assumption that before striking down a rate for impairing a competing mode's inherent advantage, the Commission will make findings specifically directed to the criteria it has adopted for defining inherent advantage and an analysis that articulates a reasoned basis for selecting those criteria. Yet, although the Commission recognized that in the instant case it was determining the fundamental standard for measuring and protecting inherent advantage (A. 65), it wholly failed to furnish a satisfactory explanation for its action.

The Commission computed the rail out-of-pocket cost (468.9 cents), rail fully-distributed cost (759.4 cents) and undifferentiated barge cost (519.6 cents) on the basis of cost studies derived from official reports by the carriers to the Commission (A. 38). But it never analyzed these studies for the purpose of determining whether their component elements were suitable for intermodal comparisons. It found that the barge lines had the inherent advantage because their fully-distributed cost is lower than the rail fully-distributed cost (A. 71). But it did not explain why the barge-truck costs indicated greater economic efficiency. It pointed out that as between regulated

and unregulated carriers, it had consistently permitted comparative out-of-pocket pricing (A. 67). But it did not indicate why this criterion was inappropriate as between regulated rail and water carriers. It noted the substantial economic arguments advanced by the railroads to show that fully-distributed costs were an inappropriate and inadequate measure of inherent cost advantage (A. 66–67). But it gave no other explanation for rejecting these arguments than to state "merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic woud make to its overhead, does not necessarily mean that the carrier is the more efficient of the two" (A. 67–68).

Similarly, the Commission made no finding as to relative efficiency. It gave no consideration to the comparative service advantages the two competing modes offered to shippers, and made no attempt to assess the overall inherent advantage in terms of both cost and service. It found that the barge-truck lines could not compete effectively even though they had not been undercut, because the railroads might subsequently attempt further reductions, then raise the rate after the barge competition had been destroyed (A. 71). But it ignored its authority to bar such predatory action under 49 U.S.C. 4(2), which is specifically aimed at this practice.[3] It did not con-

[3] 49 U.S.C. 4(2) provides: "Wherever a carrier by railroad shall in competition with a water route or routes reduce the rates

sider the fact that the railroads had simply matched the barge-truck rate, thus offering shippers a choice of two alternate modes at the same cost, in which service advantages would be the decisive factor. And although its prior decisions did not explain its rationale for using the fully-distributed-cost standard,[4] it stated that it would not depart from them on this record even though it contained comprehensive economic testimony. Its only reason was that more extensive testimony was being offered in a pending rulemaking proceeding (A. 70).

The Commission's opinion thus left unanswered questions crucial to its finding of inherent advantage: why one mode was inherently more efficient than the other; in the light of all relevant factors, why the elements used to determine comparative fully-distributed and out-of-pocket costs were appropriate for intermodal comparison;[5] and, most important of all, why fully-distributed rather than out-of-pocket costs or some other measure was the best test of inherent cost advantage.

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on the carriage of any species of freight to or from competitive points, it shall not be permitted to increase such rates unless after hearing by the Commission it shall be found that such proposed increase rests upon changed conditions other than the elimination of water competition."

[4] *Grain in Multiple-Car Shipments—River Crossings to the South*, 325 I.C.C. 752, 772; *Pig Iron, Buffalo, N.Y. to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121, 129–130; *Electric Cable & Wire, Worcester, Mass., to Houston, Tex.*, 319 I.C.C. 390; *Plastics from Texas to the East*, 319 I.C.C. 379; *Frozen Juice and Fruit from Florida to the North*, 319 I.C.C. 577; and *Candy and Confectionery from N.J., N.Y., & Pa. to Tex.*, 321 I.C.C. 154.

[5] Fully-distributed costs were determined by adding to the rail out-of-pocket costs an allocated portion of the railroad's

This determination, as the Commission itself recognized, went to the fundamental issue before it (A. 65). Since the statute gives no express guidance as to the appropriate criterion, it was incumbent upon the Commission to consider all substantial economic evidence submitted to it and to explain why one viewpoint should prevail over another. The testimony supporting use of an out-of-pocket cost standard, advanced by four distinguished economists (A. 81–160), merited specific analysis. It indicated that fully-distributed costs can never measure inherent advantage accurately. To begin with, demand for transportation service is elastic. No price formula on particular traffic can guarantee recovery of all constant and fixed costs assigned to that unit. Because the total revenues generated depend on volume multiplied by price, higher prices usually will result in less volume and therefore higher fixed costs per unit. Moreover, the concept of fully-distributed costs and the related concept of profit is a matter of accounting practice, not economic

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constant expenses. There are an infinite number of ways of allocating constant costs to arrive at fully-distributed costs (A. 93), depending on the method used; differences here between rail and barge-truck fully distributed costs range from 239.8 cents to 28.8 cents (A. 38–39). Included in the constant expenses of the railroads were deficits arising from their carriage of passengers and less-than-carload traffic. Passenger traffic is ordinarily deficit service and has no bearing on relative efficiency in providing freight service. The Commission never explained why in comparing the inherent advantages of each mode here it included in fully-distributed rail costs such expenses even though the barge-truck mode does not provide passenger service.

superiority. There are a variety of ways of computing full costs, depending on what items and how much of them are to be allocated as constant expenses to particular traffic (see note 5, *supra*).

Comparison of fully-distributed costs also distorts inherent advantage because it compares unlike factors not necessarily related to efficiency in carrying particular traffic. Thus, rail overhead here included items for services the barge-truck lines do not provide—the railroads' passenger and less-than-carload deficits. Moreover, the full-cost concept disregards the fact that most constant costs have already been expended. Bridges, rights-of-way, excess trackage and excess capacity represent costs which, like the costs of the highways and waterways, have already been paid, and they must be borne by the carrier or the public whether or not the facilities are used to carry parular traffic. Thus, as long as a carrier of any mode can cover its out-of-pocket costs and earn something towards defraying part of its fixed costs, the economy as a whole benefits and the burden on other parts of the carrier's traffic to contribute to constant costs is reduced.

Out-of-pocket costs thus allocate the carriage of particular traffic to whichever mode can move it at the least additional or incremental cost. They therefore represent a determination of inherent advantage by the market for that traffic, and take account not only of costs but of comparative service advantages. To achieve competition and the optimum allocation of transportation costs, therefore, comparative incremental costs for particular traffic represent the most

economically sound method of determining inherent advantage and thus the best means of achieving the ends sought by the National Transportation Policy.

These views, which were presented at length to the Commission, are supported not only by the substantial body of economic thought expressed by the witnesses, but by the Council of Economic Advisers and the Department of Commerce (see Economic Report to the President 1966, p. 127; Department of Commerce, Federal Transportation Policy and Program, Appendix 37).[6] Yet they were brushed aside without even the benefit of a critical analysis or a comparative weighing against the view which prevailed.

3. In its brief in this Court the Commission attempts to supply the analysis which the agency itself failed to provide in its opinion. As an initial matter, this seems at best a questionable practice, in light of this Court's admonition that "[t]he courts may not accept appellate counsel's *post hoc* rationalizations for agency action * * *." *Burlington Truck Lines* v. *United States,* 371 U.S. 156, 168–169; see also *Securities & Exchange Commission* v. *Chenery Corp.,* 332 U.S. 194, 196; *National Labor Relations Board* v. *Metropolitan Life Ins. Co.,* 380 U.S. 438, 442–444. In any event, the position now espoused by the Commission is unsound. What the Commission in substance argues (although it did not so find) is that water carriers *always* have an inherent cost advantage because, un-

[6] Similarly, the Department of Transportation strongly supports the view of the district court "that the Commission failed to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, *i.e.*, above relevant out-of-pocket costs" (A. 31).

like railroads, they incur no right-of-way costs. Then, citing *Grain in Multiple-Car Shipments—River Crossings to the South*, 321 I.C.C. 582, 325 I.C.C. 752, which it contends was incorporated by reference into its opinion, the Commission asserts that the *Grain* case recognize this inherent advantage. But the only reference to the *Grain* case in the Commission's opinion was a quotation to the effect that fully-distributed costs have generally been employed by the Commission in determining inherent cost advantage. Moreover, the *Grain* case simply held, in accordance with the purposes of the National Transportation Policy, that the Commission would not prevent water carriers from asserting their inherent advantages by requiring them to *raise* their rates at the demand of the railroads. It did not hold or indicate that rail rates should be held up to the barges' cost levels or that such action was necessary to protect the barges' inherent advantage from undue impairment or destruction.

In addition, the premise of the Commission's argument—that water carriers always have the inherent cost advantage—begs the very question that body must initially resolve. Even though water and motor carriers incur no right-of-way costs, it does not follow that in determining inherent advantage for ratemaking purposes the Commission is to weigh the right-of-way costs of the railroads against them. As we have indicated, if incremental costs for carrying particular traffic are the standard, then it is the railroads which have the inherent advantage on the carriage of the particular traffic here involved. Obviously, if the

barge carriers always have the inherent advantage under the National Transportation Policy, then there has never been anything for the Commission to resolve, the *New Haven* case was erroneously decided, and Congress accomplished nothing when it added Section 15a(3) to the Act in 1958.

Finally, the Commission argues that out-of-pocket costs were rejected as the basis for determining inherent advantage because the traffic involved is important to the competing barge lines and would be reduced or lost if the reduced rail rate was allowed. We agree, as did the district court (A. 24, 25), that this appears to be the primary motivation for the Commission's decision. But, as the Court said in *New Haven* (372 U.S. at 759): "If there is one fact that stands out in bold relief in the legislative history of §15a(3), it is that Congress did not regard the setting of a rate at a particular level as constituting an unfair or destructive competitive practice *simply* because that rate would divert some or all of the traffic from a competing mode." If a mode's "need" for traffic is the criterion for determining inherent advantage, then the Commission has *carte blanche* to engage in the kind of protectionism which Congress has consistently opposed ever since the Interstate Commerce Act was extended to intermodal competition. This would turn Congress's purpose in Section 15a(3) and the Transportation Act of 1940 upside down.

The National Transportation Policy derived from and superseded Section 202(a) of the Motor Carrier Act of 1935. (49 Stat. 543, repealed, 54 Stat. 920).

When truckers came under Commission regulation, Section 202(a) was adopted to prevent the agency from keeping motor carrier rates at high levels in order to protect the railroads (79 Cong. Rec. 5650 (remarks of Senator Wheeler, the floor manager)). Congress, therefore, directed the Commission in Section 202(a) to recognize and preserve the inherent advantage of motor carriers by permitting them to assert that advantage through low rates. When water carriers were brought under Commission regulation in 1940, their fear that their rates would be forced up to railroad levels led Congress to incorporate the same inherent advantage language into the National Transportation Policy (84 Cong. Rec. 6126–6128 (remarks of Senator Wheeler)). During the debates on the 1940 Act, Congress expressly rejected proposals which would have required use of a fully-distributed cost standard.[7]

The Commission itself recognized in 1945 that the purpose of the National Transportation Policy was to permit vigorous intermodal competition at compensatory rate levels. *New Automobiles in Interstate Com-*

[7] During the debates both the House and the Senate adopted a provision (the Miller-Wadsworth Amendment) which would have required the Commission to consider "overhead and all other elements entering into the cost to the carrier * * * for the services rendered" (84 Cong. Rec. 6074, 9962, 9977). It was eliminated in conference, however (H. Rep. No. 2832, 76th Cong. 3d Sess., pp. 87–89, 86 Cong. Rec. 10172), and, although vigorously debated, was not restored (86 Cong. Rec. 10193–10194, 11766–11767). Various similar proposals also failed of passage. See H.R. 2531, 76th Cong., 1st Sess., Sec. 41; Hearings on S. 1310 and S. 2016, S. 1869 and S. 2009 before the Senate Committee on Interstate Commerce, 76th Cong., 1st Sess., p. 698.

merce, 259 I.C.C. 475. Section 15a(3) was adopted, as this Court recognized in *New Haven* (372 U.S. at 756–758), primarily because the Commission had departed from the *New Automobiles* decision. The Commission's attempt to use this history in support of its action in this case is inconsistent with the legislative background and with this Court's construction of the congressional purpose in *New Haven.*

In sum, the Commission's present approach amounts to a return to the faults Section 15a(3) was intended to correct. The district court accurately perceived this. Its holding that the Commission's decision here is inconsistent with the purposes of Section 15a (3) does not, contrary to the Commission's contention, impair the agency's initial responsibility to determine inherent advantage. It simply recognizes that without a sound basis for such a determination, a decision holding up the rates of one mode to protect another achieves precisely the result Congress sought to avoid.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be affirmed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,
Appellants,

v.

LOUISVILLE & NASHVILLE RAILROAD CO., AND PENNSYLVANIA RAILROAD CO., ET AL.,
Appellees.

On Appeal from the United States District Court for the Western District of Kentucky

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APPELLANTS' REPLY BRIEF

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APPELLANTS' REPLY BRIEF

Appellants, American Trucking Associations, Inc., National Motor Freight Traffic Association, Inc., and National Tank Truck Carriers, Inc., for their reply to the brief of the railroad appellees herein,[1] say to this Honorable Court:

Preliminary

The brief of the rail appellees, in its broad outlines, construes the legislative history relating to enactment of Section 15a(3) of the Interstate Commerce Act, and the

[1] The appellees have filed a single brief in this case and those consolidated with it, Nos. 797, 808, and 809.

conclusions to be drawn therefrom, entirely differently than do these appellants. The same holds true with respect to the question of whether the Commission's decision has a rational basis. This is hardly surprising, and ordinarily we would file no reply. However, we deem it important to call the Court's attention to certain of the appellees' assumptions—not supported by the Commission's report—which they make, and which they misstate as Commission "findings" for the purpose of supporting their argument.

Appellees Have Misstated the Commission's Findings

The first of these misstatements (p. 3)[2] is that the "Interstate Commerce Commission found that the reduced rail rate of $5.11 per gross ton on ingot molds is required by the railroads if they are to effectively compete for the traffic." Turning to the citation furnished by appellees (A. 61-62), we find that the language they rely on begins with the phrase, which they somehow overlook: "According to consignee testimony." Thus, what the Commission "found"—to put it accurately—was no more than that the *consignee said* that the railroads could get the traffic only if they met the barge-truck rate. The appellees, we submit, have made an exceedingly poor "translation" of clear and simple English language in an effort to raise the Commission's recitation of the *consignee's* statement to the level of a Commission finding.

The second such misstatement (p. 3) is the claimed finding *by the Commission* that the reduced rail rate is "compensatory." The citation to the record (A. 62-63) reveals only that the Commission stated that "Division 2 then concluded that the rate was compensatory . . ."[3]

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[2] All page references herein, unless specifically indicated otherwise, are to the brief of railroad appellees.

[3] The word "compensatory," like most words, means many things to many people. The rail brief (pp. 25-27) notes the reference by several members of Congress to "compensatory" rates. We assume

The third such misstatement is the claimed Commission finding (p. 5) that the rail rate "would make a maximum contribution toward the railroads' constant expenses . . ." This "finding," to use the appellee's citation (A. 67), is apparently based on the following language in the Commission's report:

> . . . merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, *and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead*, does not necessarily mean that the carrier is the more efficient of the two. (Emphasis ours)

A fair reading of the cited passage makes it clear that the Commission was doing no more than accepting, *arguendo*, the rails' hypothesis with respect to their reduced rate, and saying that, even so, their service was not shown thereby to be more "efficient" than the barge-truck service. It seems to us improper to state to this Court, as appellees have, that this constitutes a "finding" by the Commission in the form in which they have cast it. The balance of the claimed finding, "that the railroads would be better off with the reduction than without it" is also entirely devoid of support in the Commission's report.

The appellees have thus created findings not made by the Commission and relied on them to buttress their argument. This same technique is followed elsewhere in their brief. See, for example, the statement at page 10, that the Commission found "the railroads' reduced rate

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the appellees mean to imply that the use of this word by the Congressmen in question connotes their approval of out-of-pocket cost ratemaking. Since we lack the ability to know what they meant by "compensatory," we content ourselves in the knowledge that the appellees are probably no more skilled at mind reading than are we. We would only add that—if Congress meant to use the word as the appellees apparently construe it—it would have been a simple matter to so define it and include it in the legislation it enacted.

compensatory; not detrimental—but actually beneficial—to the railroads' revenue needs; and required for effective competition, . . ." And, again, their reiteration (p. 16) that "[h]ere, as the Commission found, the reduced ingot molds rate, by attracting traffic, will increase the contribution to the railroads' constant expenses, . . ."

Any pleader is entitled to make the most he properly can out of any factors he considers favorable to his cause and make a reasonable interpretation of ambiguous language. Unfortunately, that is not the case here; appellees have simply indulged in wishful thinking, and, in turn, attempted to support their ratemaking philosophy by conjuring up "findings" which the Commission did not, in fact, make.

Even had the Commission made the finding attributed to it by appellees, it would have cast no doubt on the Commission's power (1) to use full cost to determine which of the competing modes has the inherent cost advantage and (2) to restrain the railroads from maintaining rates below the full cost of the low cost mode in order to recognize and preserve to the latter its inherent advantage.

The Testimony of Rail Economists Was Controverted and the Commission Was Not Obliged to Adopt It

In their ardor to support their contention that rates based on out-of-pocket costs are the only proper criteria for determining which of two competing transport modes has the "inherent advantage," the appellees again misstate the facts in their claim that the testimony of the economists whom they presented was "uncontroverted" (p. 10), or "not refuted" (p. 33).[4] *This simply is not so.* As

[4] The rail brief (p. 36, n. 78) also refers to the 1966 Report of the Council of Economic Advisers and the 1957 Report of the Royal Commission on Canada's Economic Prospects. Assuming, as the railroads claim, that these reports support their ratemaking philosophy, we weren't aware that either of these groups played any part in the enactment, in 1958, of Section 15a(3) of the Interstate Commerce Act.

we noted in our original brief (p. 20, n. 21) there was "countervailing testimony. See that of Witness Steiner, A. 178 *et seq.*, particularly A. 203-224." We would hardly expect appellees to embrace the testimony of the transportation economist presented by the barge lines. But we would expect them, at least, to admit his participation in the proceeding and his disagreement with the conclusions of their economists.

On the question of whether the findings of the Commission are sufficient to provide a rational basis for its ultimate conclusions and order, appellees quarrel at length with the merits of its refusal to accept as controlling the views expressed by their retained economists (pp. 32-43). The lower court agreed with those witnesses and substituted its judgment for that of the Commission as to the controlling significance thereof. Such a course is clearly beyond the function of a reviewing court. There would appear to be no reason to argue that proposition further.

We note in conclusion on the question of rationality that appellees make no effort to dispute the logic of the reasons on which the Commission rested its ultimate conclusions and order. Those reasons are set forth in the brief of these appellants (pp. 20-24) and we rest our case on what we there said.

The Commission Found the Rail Rate Predatory

Appellees refer (p. 43, n. 102) to our contention, also made by other appellants, that "the opinion of the court below will enable the railroads to destroy their intermodal competitors." In addition to characterizing this contention as "false and misleading," appellees allege a "total absence of any findings by the Commission that the ingot molds reduction is predatory or maliciously conceived." [5] We have previously noted, in another context, the appel-

[5] See also (p. 6) the contention that "There is no finding . . . [that the rail rate is] predatory in the sense that it is aimed at the destruction of a competitor or involves unfair pricing practices."

lees' "exceedingly poor translation of clear and simple English language" in the Commission's report. Here the reverse is true. Appellees seem singularly unable or unwilling to recognize the import of equally clear language in the Commission's report. Referring to the conclusion of Division 2 that the barge cost advantage would enable the water carriers to reduce their rates and still be able to compete effectively, the Commission said (A. 71):

> Nothing in that report suggests that such a reduction in the rate of the barge-motor lines cannot be matched by successive reductions in the railroad rates. The railroad out-of-pocket costs are lower than the barge-motor lines' variable costs. Therefore, the railroads can wage the rate battle as long as or longer than the barge-motor lines. The rationale of the division's report would permit no ground upon which the Commission would be able to intercede to halt such a devastating rate war. While this may give full rein to the "play of competition," 323 I.C.C. 758, 764, it is difficult, if not impossible, to comprehend how it would accord recognition and preservation of inherent advantages as contemplated by the national transportation policy.
>
> In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. . . .

Short of using the exact word, we submit that this portion of the Commission's report could hardly more clearly state the conclusion that the railroad rate involved, in transportation parlance, is "predatory" in the sense that it constitutes an unfair or destructive competitive practice proscribed by the National Transportation Policy.

The Rail Claims Regarding Motor-Carrier Taxation and Their Right-of-Way Cost "Disability" Are Erroneous

The appellees' brief (pp. 11, 12, 45, 46, 47) repeatedly claims that their water and motor competitors use "Gov-

ernment supplied rights-of-way, either free or without the payment of adequate user charges."[6] Insofar as their claim that motor carriers use highways at "inadequate user charges" is concerned, the railroads substitute their own *ipse dixit* for fact. The only impartial public studies ever made of the adequacy of truck highway use tax payments on a national basis found that they paid more than their fair share. This was the conclusion of a study conducted by Joseph B. Eastman, Federal Coordinator of Transportation. Public Aids to Transportation, Vol. IV (1940). A later study by the Bureau of Public Roads, submitted to Congress March 24, 1965,[7] found that trucks paid more than their fair share of federal highway costs in the form of use taxes. Surely, appellees are familiar with these studies.

Information received from the various States and collated by ATA's Department of Research and Transport Economics, and contained in the publication "Truck Taxes by States," shows total truck highway user taxes paid to the States of $2.465 billion in 1966. Federal highway user taxes paid by trucks for the same year totaled $1.707

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[6] Appellees acknowledge, at least tacitly, that trucks pay taxes for highway use, but, without citing any evidence—much less record evidence—make the claim that they are inadequate. Aside from the slipshod nature of this type of argument, we think it comes with singularly poor grace from the recipients of the greatest largesse ever bestowed upon any mode of transport, in the form of grants equalling almost 10% of the total land area of the United States (excluding Alaska)—much of it containing valuable oil and mineral rights—plus a great variety of state and municipal "plums," such as contributions of cash, subscriptions to and guarantees of railroad bonds, materials, equipment, construction labor, securities, tax exemptions, and the use of city streets at grade, free of any costs. Public Aids to Transportation, Vol. II—Aids to Railroads and Related Subjects, U.S. Federal Coordinator of Transportation (1938). Even today, of course, railroads are given public subsidy in the form of tax relief and outright payments by the federal, state and municipal goverments, largely in connection with commuter transportation.

[7] Supplementary Report of the Highway Cost Allocation Study, House Doc. No. 124, 89th Cong., 1st Sess.

billion, for a total figure of $4.172 billion paid in highway user taxes only. This figure, of course, does not include a myriad of other non-highway-user taxes, state, local, and federal, such as income, real property and sales taxes.

While appellees are *technically* correct in their claim (p. 46), that "the cost of such [highway] facilities [is] not included in [motor carriers'] out-of-pocket costs," the fact is that the very large sums paid in taxes for the use of such facilities *is* included in motor carrier out-of-pocket costs. Thus the rail "disability of paying for their rights-of-way" is matched, and far more than matched,[8] by the similar "disability" incurred by motor carriers by the payment of highway user taxes.

Appellees Confuse the Concept of Pricing Floors

The appellees repeatedly refer to "full cost floors" in the discussion contained at pages 21-29 of their brief, and thus do not distinguish between using full cost of the proponent of a rate as a measure of compensativeness, and using full cost of the low cost mode as a means of determining when the rate of a higher-cost mode constitutes a destructive competitive practice. This is the use the Commission made of full costs in the instant case, and we submit that such use is consistent with this Court's *New Haven* decision. This confused discussion in appellees' brief throws no light on the question of statutory interpretation, i.e., whether the Commission has power to use full cost as it did, but does indicate how little merit, when tested by logic and relevance to the issues, there is in what appellees say.

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[8] Total railroad taxes *of all kinds* paid to the federal, state, and municipal governments in 1965, the latest year for which the figure is available, were only $915 million. Transport Statistics in the United States (I.C.C.), Part I, page 22, Table 107.

Appellees Have Ignored a Significant Holding in This Court's *New Haven* Decision

Finally, we wish to call the Court's attention to the complete failure of appellees to take issue with the contention, made in our original brief (pp. 17-20)[9] that "this Court's *New Haven* decision anticipated *exactly* the situation here involved and established a guidepost which the court below ignored." Nowhere in their 48-page brief do the appellees take any issue with this proposition. Their failure so to do amounts, we submit, to a concession of its validity.[10]

Comment on Brief of the United States

The fact that these appellants did not receive the government's brief until late in the day (April 15), combined with the setting of argument for April 23, has restricted our opportunity to give other than cursory treatment to the government's brief. Our brief in reply to that of the rail appellees (the material preceding this heading) went to the printer within an hour or two of receipt of the government's brief. The short time remaining before argument herein prevented redrafting to fully extract and answer, independently, the contentions raised in the brief of the United States.

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[9] The brief of rail appellees (p. 41) erroneously describes that portion of our brief as an argument that the "Commission's reference to *New Haven* supplies a rational basis for comparing 'fully-distributed costs' to determine low-cost advantage." Our argument dealing with the rationality of the Commission's decision is contained at pages 20-24 of our brief.

[10] In *American Trucking Ass'ns.* v. *United States*, 364 U.S. 1 (1960), this Court overturned an I.C.C. decision granting substantial rights to a railroad's motor subsidiary. A small portion of the total grant, it noted, had "been submerged in the * * * broader permit * * *." The Court (*Id.*, 17) said:

> [Rail] [a]ppellees maintain that there was such justification [for the grant], and [motor carrier] appellants have not established that it was lacking. Nor do we perceive any other reason to upset this award. Consequently, we affirm with respect to this particular permit.

In any event, the brief of the United States concentrates largely on two points: (1) that the Commission chose the wrong standard in determining which of the two competing transport modes possessed the inherent advantage of low cost, and should, instead, have used the standard of comparison favored by the Department of Justice, i.e., out-of-pocket rather than fully-distributed, cost;[11] (2) that the Commission gave no "sound justification" for its use of the fully-distributed cost standard. As to the first proposition, we need merely point out that it is the Commission which has the primary obligation, as well as the administrative expertise, to make the choice. As to the second, the argument, in essence, is that the Commission's decision lacks a rational basis.[12] For answer to this, we refer the Court to our original brief on the merits (pp. 20-24).

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[11] We note the government's claim (p. 17, n. 6) that the Department of Transportation "strongly supports the view of the district court," etc. In this connection see our comment, *supra*, p. 4, n. 4 relative to a similar claim by rail appellees.

[12] This is also true of the government's contention (p. 15) that the Commission did not rebut, by "specific analysis," the testimony "advanced by four distinguished economists" presented by the railroads.

CERTIFICATE OF SERVICE

I, Peter T. Beardsley, one of the attorneys for appellants herein, and a member of the bar of the Supreme Court of the United States, hereby certify that, on the 17th day of April, 1968, I served copies of the foregoing document on the several parties hereto, in duly-addressed envelopes, with postage prepaid, as follows:

1. On Honorable Erwin R. Griswold, The Solicitor General, Department of Justice, Washington, D.C. 20530, and on Donald F. Turner, John H. D. Wigger, and Robert Johnson, Esqs., Department of Justice, Washington, D. C. 20530.

2. On Robert W. Ginnane, Esq., General Counsel, and Leonard S. Goodman, Esq., Assistant General Counsel, Interstate Commerce Commission, Washington, D. C. 20423.

3. On Harry C. Ames, Jr., Esq., 529 Transportation Building, Washington, D. C. 20006, J. Raymond Clark, Esq., 743 Investment Building, Washington, D. C. 20036, and A. Alvis Layne, Pennsylvania Building, Washington, D. C. 20004, counsel for appellant barge lines.

4. On Carl Helmetag, Jr., Esq., Six Penn Center Plaza, Philadelphia, Pa. 19103, Elbert R. Leigh, Esq., 908 West Broadway, Louisville, Ky. 40201, and Harry J. Breithaupt, Jr., Esq., 929 Transportation Building, Washington, D. C. 20006, counsel for appellees.

PETER T. BEARDSLEY

UPREME COURT, U. S.

FILED

APR 19 1968

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No. 808

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

THE AMERICAN WATERWAYS OPERATORS, INC.,
Appellant,

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and PENNSYLVANIA RAILROAD COMPANY, ET AL.,
Appellees.

On Appeal From the United States District Court for the Western District of Kentucky at Louisville

REPLY BRIEF FOR THE AMERICAN WATERWAYS OPERATORS, INC.

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April 1968

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

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1. The railroads' counsel have simplified this Court's task by conceding that the Commission may condemn even a compensatory rate if it is "aimed at destroying a competitor" (Railroad Appellees' Brief, p. 28). Their argument now rests on the hope that this Court will follow the District Court in overlooking the facts

showing the rail rate cut in issue here was indeed aimed at destroying a bargeline competitor.

The Commission's finding that at the $5.11 rate "rail respondents virtually concede that all of the traffic would move by rail" (J.A. 64) is now countered by the assertion of railroad counsel that this reduction only gave "the shipper a choice of two competitive services at the same price" (Railroad Appellees' Brief, p. 37). The fact that the competing bargeline would have to undercut the rail $5.11 rate to participate in this traffic, and the fact that the bargeline can not recapture this traffic by such a reduction because the rails' out-of-pocket costs are lower than the barges' (J.A. 71) are all facts that are ignored instead of disputed.

Railroad counsel assert in the face of these facts that the $5.11 rate was not predatory "in the sense that it is aimed at the destruction of a competitor or involves unfair pricing practices" (Railroad Appellees' Brief, p. 6). They suggest, but do not argue, that this deliberate pre-emption of traffic vital to a competitor's survival was not predatory because the Commission failed to find that the $5.11 rail rate was "maliciously conceived" (*Id.* at 43, footnote 102).

Intermodal competition can not be protected against destructive rate-cutting by probing the minds of railroad rate makers for evidence of malice. Here, objective evidence shows that (1) the existing rate was cut by more than half (11.86 to 5.11) to a level where the ratio (109) of the rate to out-of-pocket costs fell far below the average ratio (152) for other manufactured products (J.A. 144); (2) revenues from transportation of the particular class of manufactured products involved "is of far more consequence to the barges than

to the railroads" (J.A. 68); (3) the cut rate captured all of this traffic for the railroads (J.A. 64); and (4) the bargelines can not recapture the traffic by engaging in a rate battle with the railroads (J.A. 71).

If these facts do not justify the Commission's conclusion that the reduction threatened the ability of the competing bargelines "not only to compete but to exist" (J.A. 68), an additional finding of malicious conception could not do so. The railroad appellees' own argument as to the meaning of the statute assumes, as do the appellants' arguments, that Congress authorized the Commission to protect intermodal competition by appraising the economic consequences of a rate cut—not by applying the law of malicious torts.

2. The Justice Department's brief, on the other hand, claims that there is no prospective Commission remedy against a predatory rail rate that is compensatory. According to its brief, the Commission lacks power to suspend such a rate aimed at the destruction of bargelines and may only prevent the railroad from increasing the destructive rate "after the barge competition had been destroyed" (Brief for the United States, p. 13). The Department argues that instead of preventive action pursuant to section 15a(3) of the Act the Commission should rely upon section 4(2) to deny to the railroads the privilege of increasing the destructive rate after it had accomplished the objective of destroying a competing water carrier.

The authors of the Justice Department brief seem to assume that the only provision allowing prospective condemnation of predatory rates is 49 U.S.C. § 15(1), which prohibits non-compensatory rates, regardless of their purpose. *State of New York* v. *United States,*

331 U.S. 284, 346 (1947). The fact is that the issue of predatory purpose normally arises in a proceeding under 49 U.S.C. § 15a(3). There is no occasion to invoke 15a(3) unless the allegedly destructive rate exceeds out-of-pocket costs, as a rate below that level is prohibited by 15(1) and 15a(2). Thus, the Department's notion that, in the absence of a non-compensatory rate, a market free from Commission interference should determine intermodal cost advantages, rests upon a failure to comprehend the statutory framework for Commission regulation of rates.

In *Interstate Commerce Commission* v. *New York, N.H. & H.R.R. Co.*, 372 U.S. 744 (1963), the Justice Department filed a brief that, while disagreeing with the Commission, carefully considered the background and purpose of the 1958 amendment to section 15a(3), as applied to the facts of rail-water competition. The Justice Department then concluded that a water carrier should in all circumstances receive Commission protection against any rail rate reduction that would impinge upon a water carrier's inherent cost advantage, measured by fully distributed costs. (Brief for the United States, pp. 21, 40-41, No. 108, *et al.*, Oct. Term). This Court apparently regarded that formula as too rigid, but, as all parties concede, this Court did not rule out the use of fully distributed costs for this purpose. Instead of addressing itself to the facts thought by the Commission in this case to justify a fully distributed cost comparison to determine the low-cost carrier, the Justice Department has chosen to join the railroads in their effort to achieve now what they were denied in *New Haven; i.e.*, total elimination of fully distributed cost comparisons in all cases where rail-water competition is involved. We do not question

the Justice Department's right to reverse its position, although repudiation of an argument as to the meaning of a statute normally does not occur in the very next case presenting the same question. We do suggest, however, that the failure of the Department's current brief to describe accurately the statutory basis of the Commission's power makes the Department's brief in *New Haven* a more useful aid to a correct decision here than the Department's present brief.

Respectfully submitted,

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April 1968

SUPREME COURT OF THE UNITED STATES

Nos. 797, 804, 808, AND 809.—OCTOBER TERM, 1967.

American Commercial Lines, Inc., et al., Appellants, 797 v. Louisville & Nashville R. Co. et al. American Trucking Associations, Inc., et al., Appellants, 804 v. Louisville & Nashville R. Co. et al. The American Waterways Operators, Inc., Appellant, 808 v. Louisville & Nashville R. Co. et al. Interstate Commerce Commission, Appellant, 809 v. Louisville & Nashville R. Co. et al.	On Appeals From the United States District Court for the Western District of Kentucky.

[June 17, 1968.]

MR. JUSTICE MARSHALL delivered the opinion of the Court.

The basic issue in this case is whether the action of the Interstate Commerce Commission in disallowing a rate reduction proposed by the appellee railroads, 326 I. C. C. 77 (1965), was consistent with the provisions of § 15a (3) of the Interstate Commerce Act, 49 U. S. C. § 15a (3), added by 72 Stat. 572 (1958), which governs ratemaking in situations involving intermodal competition. A subsidiary but related issue is whether the Commission adequately articulated its reasons for disallowing the proposed rate. A statutory three-judge court, upon appeal of the Commission's decision by the appellee railroads, held that the Commission's decision was erroneous

on both of the foregoing grounds. 268 F. Supp. 71 (D. C. W. D. Ky. 1967). Because of the importance of § 15a (3) as the primary guide to ICC resolution of rate controversies involving intermodal competition, we noted probable jurisdiction of the appeal taken by the Commission and the competing carriers from the decision of the District Court.[1] 389 U. S. 1032 (1968). For the reasons detailed below, we conclude that the District Court erred in its rejection of the Commission's decision, and the grounds on which it was based, and we reverse.

I.

Since 1953 the movement of ingot molds from Neville Island and Pittsburgh, Pennsylvania, to Steelton, Kentucky, has been almost exclusively by combination barge-truck service, and since 1960 the overall charge for this service has been $5.11 per ton. In 1963 the Pennsylvania Railroad and the Louisville & Nashville Railroad lowered their joint rate for this same traffic from $11.86 to $5.11 per ton. The competing barge lines, joined by intervening trucking interests, protested to the ICC that the new railroad rate violated § 15a (3) of the Interstate Commerce Act because it impaired or destroyed the "inherent advantage" [2] then enjoyed by the barge-truck service. The Commission thereupon undertook an investigation of the rate reduction.

In the course of the administrative proceedings that followed, the ICC made the following factual findings

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[1] The United States, a statutory defendant in the District Court, supported the railroads' position there and has participated in support of them in the proceedings before this Court.

[2] The term "inherent advantage" comes from the National Transportation Policy, 49 U. S. C. preceding § 1, and is incorporated by reference into § 15a (3) of the Interstate Commerce Act. The meaning of the term is the central issue in this case and will be discussed in considerable detail *infra*, at 6–21.

about which there is no real dispute among the parties. The fully distributed cost [3] to the railroads of this service was $7.59 per ton, and the "long term out-of-pocket costs" [4] were $4.69 per ton. The fully distributed cost to the barge-truck service [5] was $5.19 per ton.[6] The out-of-pocket cost [7] of the barge-truck service was not sep-

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[3] Fully distributed costs are defined broadly by the ICC as the "out-of-pocket costs plus a revenue ton and revenue ton-mile distribution of the constant costs, including deficits, [that] indicate the revenue necessary to a fair return on the traffic, disregarding ability to pay." New Automobiles in Interstate Commerce, 259 I. C. C. 475, 513 (1945).

[4] The long-term out-of-pocket costs were computed under an ICC-sponsored formula which generally holds that 80% of rail operating expenses, rents and taxes are out-of-pocket in that they will vary with traffic. To this is added a return element of 4% on a portion of the investment (all the equipment and 50% of the road property), which is apportioned to all traffic on a proportional basis. Compare n. 3, *supra*.

[5] This figure is not precisely a cost figure. Rather it is the barge fully distributed cost, plus the charge made for the truck portion of the service and the charge for barge-truck transfer. Since all parties seem willing to treat the figure as one of fully distributed cost for the barge-truck combination, no further mention will be made of its disparate elements.

[6] Because the barge-truck rate of $5.11 was below the fully distributed cost of the service, Division 2 of the ICC initially concluded that the barge-truck combination had forfeited its right to claim that its inherent advantage of lower fully distributed cost was being impaired by the railroads' setting of a matching rate. On reconsideration, the full Commission reversed this ruling by Division 2, observing that there was no evidence that the failure of the barge-truck rate to equal fully distributed cost was due to anything but the barge lines' ignorance of the precise amount of their fully distributed cost for this service. This determination is not challenged here by any party and we express no opinion on it.

[7] Out-of-pocket costs have been regarded generally in this case as equivalent to what economists refer to as "incremental" or "marginal" costs. Accordingly we shall equate the terms likewise, although we have no intention of vouching for the accuracy of

arately computed, but was estimated, without contradiction, to be approximately the same as the fully distributed cost and higher, in any event, than the out-of-pocket cost of the railroads. The uncontroverted shipper testimony was to the effect that price was virtually the sole determinant of which service would be utilized, but that, were the rates charged by the railroads and the barge-truck combination the same, all the traffic would go to the railroads.

The railroads contended that they should be permitted to maintain the $5.11 rate, once it was shown to exceed the out-of-pocket cost attributable to the service, on the ground that any rate so set would enable them to make a profit on the traffic. The railroads further contended that the fact that the rate was substantially below their fully distributed cost for the service was irrelevant, since that cost in no way reflected the profitability of the traffic to them. The barge-truck interests, on the other hand, took the position that § 15a (3) required the Commission to look to the railroads' fully distributed costs in order to ascertain which of the competing modes had the inherent cost advantage on the traffic at issue. They argued that the fact that the railroads' rate would be profitable was merely the minimum requirement under the statute. The railroads in response contended that inherent advantage should be determined by a comparison of out-of-pocket rather than fully distributed costs, and they produced several economists to testify that, from the standpoint of economic theory, the comparison of out-of-pocket, or incremental, costs was the only rational way of regulating competitive rates.

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that equation as a matter of pure economics. Cf. n. 4, *supra*. Such costs are defined generally as the costs specifically incurred by the addition of each new unit of output and do not include any allocation to that unit of pre-existing overhead expenses.

The ICC rejected the railroads' contention that out-of-pocket costs should be the basis on which inherent advantage should be determined. The Commission observed that it had in the past regularly viewed fully distributed costs as the appropriate basis for determining which of two competing modes was the lower cost mode as regards particular traffic. It further indicated that the legislative history of § 15a (3) revealed that Congress had in mind a comparison of fully distributed costs when it inserted the reference to the National Transportation Policy into that section in place of language sought by the railroads. The Commission also emphasized that there was a rulemaking proceeding pending before it in which the whole question of the proper standard of costing in situations involving intermodal competition was being examined in depth, and stated that "a radical departure from the fully distributed cost norm" would not be justified on the basis of the record before it in this case.

Having decided to utilize a comparison between fully distributed costs to determine inherent advantage, the Commission then concluded that the rate set by the railroads would undercut the barge-truck combination's ability to exploit its inherent advantage because the rate would force the competing carriers to go well below their own fully distributed costs to recapture the traffic from the railroads. Moreover, since the result sought by the railroads was general permission to set rates on an out-of-pocket basis, the Commission concluded that eventually the railroads could take all the traffic away from the barge-truck combination because the out-of-pocket costs of the former were lower than those of the latter and, therefore, in any rate war the railroads would be able to outlast their competitors. Accordingly, the Commission ordered that the railroads' rate be canceled.

The District Court read the statute and its accompanying legislative history to reflect a congressional judg-

ment that inherent advantage should be determined in most cases by a comparison of out-of-pocket costs and that, therefore, railroads should generally be permitted to set any individual rate they choose as long as that rate is compensatory.[8] The court also held that the Commission had failed adequately to articulate its reasons for deciding that the proper way of determining which mode of transportation was the more efficient was by comparison of fully distributed costs rather than out-of-pocket costs. Although this latter holding appears first in its opinion, it is evident that it must logically follow its ruling on the meaning of § 15a (3), since if Congress in enacting that section had already decided that inherent advantage should be determined by reference to fully distributed costs, there would be no special burden on the Commission to justify its use of them.

II.

This Court has previously had occasion to consider the meaning and legislative history of § 15a (3) of the Interstate Commerce Act in *ICC* v. *New York, N. H. & H. R. Co.*, 372 U. S. 744 (1963) (*"New Haven"*), and both the ICC and the District Court have relied heavily on that decision as support for the conflicting results reached by them in this case. Because the statute and its relevant legislative history were so thoroughly canvassed there, we shall not undertake any extended discussion of the same material here. Instead, we shall refer to that opinion for most of the relevant history.

So far as relevant here, § 15a (3) provides that:

> "[r]ates of a carrier shall not be held up to a particular level to protect the traffic of any other mode

[8] A rate is compensatory in the sense used by the District Court any time it is greater than the out-of-pocket cost of the service for which the rate is set. The term fully compensatory is sometimes used to describe a rate in excess of fully distributed costs.

> of transportation, giving due consideration to the objective of the national transportation policy declared in this Act."

The National Transportation Policy, 49 U. S. C. preceding § 1, states that it is the intention of the Congress:

> "to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each . . . ."

The enactment of § 15a (3) in 1958 was due primarily to complaints by the railroads that the ICC had maintained rates at artificially high levels in order to protect competing modes from being driven out of business by railroad competition.[9] The bill that eventuated in the language that is presently § 15a (3) originally provided that the ICC, in considering rate reductions, should, in a proceeding involving competition with another mode of transportation, "consider the facts and circumstances attending the movement of the traffic by railroad and *not by such other mode.*" (Emphasis added.) 372 U. S., at 754. This language was objected to strongly

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[9] An illustration of such a case is the decision of the ICC that was reversed in the *New Haven* case. There the ICC had refused to permit the railroads to set a rate which was not only above their out-of-pocket cost for the service but was also above their fully distributed cost for approximately half of the movements involved. The Commission did not rely on a determination of which of the competing carriers had the inherent advantage as to costs, but instead decided broadly that the rate would eventually destroy the coastwise shipping industry and therefore should be prohibited. This Court held that, in general, the ICC was required to determine which of the competing carriers possessed the inherent advantage before a rate could be ordered cancelled in order to protect a carrier's present rate. While the Court indicated that the Nation's defense needs might permit protection of even a higher cost carrier in some cases, it held that the ICC had not adequately shown *New Haven* to be such a case.

by both the ICC and representatives of those carriers with which the railroads were in competition. See Hearings on S. 3778 before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess. (1958). The basic ground of objection was that by looking only to the effect of a rate reduction on the carrier proposing it, the ICC would be unable to protect the "inherent advantages" enjoyed by competing carriers on the traffic to which a rate reduction was to be applied.

Unfortunately, the meaning of the term "inherent advantage," which is what the Commission is supposed to protect, is nowhere spelled out in the statute. The railroads argue, and the District Court held, that Congress intended by the term to refer to situations in which one carrier could transport goods at a lower incremental cost than another. The fallacy of this argument is that it renders the term inherent advantage essentially meaningless in the context of the language and history of § 15a (3).

Since the pricing of railroad services below out-of-pocket or incremental cost would result in a net revenue loss to the railroad on the carriage, the ICC could prohibit such practices without reference to the costs of any other competing carrier. And this is precisely what the language of the bill as originally endorsed by the railroads would have provided by its use of the phrase "and not by such other mode." See p. 7, *supra*. This language was, however, rejected by the Congress and the alternative formulation proposed by the ICC, see Hearings, *supra*, at 169, was substituted for it.

As this Court said in the *New Haven* case:

> "The principal reason for this reference [to the National Transportation Policy] . . . was to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent

> advantages of other modes. And the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed cost and thus perhaps to go out of business." 372 U. S., at 758.

Since this case is identical to the example just described, it would seem that, at the very least, the result reached by the Commission here is presumptively in accord with the language of the statute and with the intent of Congress in utilizing that language.[10]

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[10] The appellees also contend, and the District Court held, that the statements in the legislative history of § 15a (3) that Congress intended to compel the Commission to return to the approach to competitive rate regulation it had utilized in the case of *New Automobiles in Interstate Commerce*, 259 I. C. C. 475 (1945), indicate that out-of-pocket ratemaking was intended to be the rule in such cases. However, the passage quoted from *New Automobiles* simply states that the rates of one mode of transportation should not be held up merely to protect competing modes. It says nothing at all about inherent advantages.

The railroads argue that the basic thrust of the *New Automobiles* case was to compare costs on an out-of-pocket basis. And it is true that many of the comparisons there made were on that basis. However, an examination of what the Commission actually said and did in *New Automobiles* compels the conclusion that no flat rule of comparison of out-of-pocket costs was there laid down. For example, the Commission concluded that on the basis of a comparison with the railroads out-of-pocket costs for shipping automobiles, the truckers were the lower cost mode only up to 120 miles. On a fully distributed cost comparison the truckers were the lower cost mode up to 230 miles. 259 I. C. C., at 528. After discussing at some length the concept of reasonable minimum rates, the Commission ultimately concluded that generally the truckers had the cost advantage at distances up to 200 miles and

The District Court, however, ignored the above portion of the *New Haven* opinion and seized on certain other language therein to the effect that:

> "[I]t may be, for example, that neither a comparison of 'out-of-pocket' nor a comparison of 'fully distributed' costs, as those terms are defined by the Commission, is the appropriate method of deciding which of two competing modes has the cost advantage on a given movement." 372 U. S., at 760.

It coupled this language with its interpretation of § 15a (3) as having the purpose to promote "hard competition," and concluded that the Commission had the burden of justifying any departure from using out-of-pocket cost as the means of determining inherent cost advantage.

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that the railroads should be permitted to set rates that would permit them to compete for the longer-haul traffic. 259 I. C. C., at 539.

Given the fact that the Commission was dealing with an attempt by the truckers to get it to hold up railroad rates for distances even greater than 600 miles, it is not surprising that the issue of measuring inherent advantage as between fully distributed and out-of-pocket costs did not receive detailed consideration, since by either method the truckers were the low cost mode only up to a little more than 200 miles. Thus it cannot fairly be said that *New Automobiles* represents a considered choice between the two methods of cost comparison. Rather what it stands for is the principle emphasized in the *New Haven* case that the rates of one mode should not be held up to protect the revenues of a competitor without regard to which is the low cost carrier.

In any event, what matters so far as § 15a (3) is concerned is not what the Commission meant in *New Automobiles* but what Congress thought it meant in 1958 when the section was enacted. As we have shown in the text of the opinion above, Congress considered *New Automobiles* to stand for the principle that the rate structure of a competing mode should not be protected by the Commission simply to prevent it from losing business through competition.

We think that the District Court erred in its reading both of the prior *New Haven* decision and of the extent to which Congress intended to foster intermodal competition. We note first that nothing in the language of the *New Haven* opinion indicates a preference for either out-of-pocket or fully distributed costs as a measure of inherent advantage; rather, all that is said is that the appropriate measure "may be" neither. Given the fact that the insertion of the reference to inherent advantage into § 15a (3) came about at the insistence of carriers that were demanding that fully distributed cost be the sole measure of that advantage,[11] we think that the clear import of the foregoing statement in the *New Haven* opinion was that the Commission *could*, after due consideration, decide that some other measure of comparative costs might be more satisfactory in situations involving intermodal competition than the one it had traditionally utilized.[12] That is a far cry from saying that it *must*.

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[11] The District Court also relied on the rejection of a similar proposal by truck and barge interests that fully distributed costs be the floor for reasonable minimum rates in the course of the enactment of the National Transportation Policy in 1940. It seems clear, however, that one of the major reasons for the rejection of the so-called Miller-Wadsworth amendment by Congress was the possibility that its enactment would prevent low-value industrial and agricultural commodities from being carried at a rate low enough to make it economically feasible to ship them in interstate commerce. See generally Nelson, Rate-Making In Transportation—Congressional Intent, 1960 Duke L. J. 221, 228–238.

[12] While it is true that, for varying and sometimes unexplained reasons, the Commission has not invariably used fully distributed costs as the basis for cost comparisons in situations involving intermodal competition, see 268 F. Supp., at 78, it is also true that it has generally declared fully distributed cost comparisons to be preferable. Thus in the hearings on the bill that was to become § 15a (3), Commissioner Freas stated:

"Whenever conditions permit, given transportation should return the full cost of performing carrier service. . . . In many

The District Court apparently believed that the Commission was required to exercise its judgment in the direction of using out-of-pocket costs as the rate floor because that would encourage "hard" [13] competition. We do not deny that the competition that would result from such a decision would probably be "hard." Indeed, from the admittedly scanty evidence in this record, one might well conclude that the competition resulting from out-of-pocket ratemaking by the railroads would be so hard as to run a considerable number of presently existing barge and truck lines out of business.

We disagree, however, with the District Court's reading of congressional intent. The language contained in § 15a (3) was the product of a bitter struggle between the railroads and their competitors. One of the

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instances, however, the full cost of the low-cost form of transportation exceeds the out-of-pocket cost of another. If, then, we are required to accept the rates of the high cost carrier merely because they exceed its out-of-pocket costs, we see no way of preserving the inherent advantages of the low cost carrier." Quoted at 372 U. S. 755.

[13] The District Court ascertained the legislative purpose to promote "hard competition" from the following passage from the New Haven opinion:

"Section 15a (3), in other words, made it clear that something more than even hard competition must be shown before a particular rate can be deemed unfair or destructive. The principal purpose of the reference to the National Transportation Policy, as we have seen, was to prevent a carrier from setting a rate which would impair or destroy the inherent advantages of a competing carrier, for example, by setting a rate, below its own fully-distributed costs, which would force a competitor with a cost advantage on particular transportation to establish an unprofitable rate in order to attract traffic." 372 U. S., at 759.

Since the sentence following the term "hard competition" described an example of the competition prohibited by the National Transportation Policy that is identical to the facts of the present case, the District Court's use of the term to reverse the ICC's decision here seems somewhat peculiar.

specific fears of those competitors that prompted the change from the original language used in the bill was that the bill as it then read would permit essentially unregulated competition between all the various transportation modes. It was argued with considerable force that permitting the railroads to price on an out-of-pocket basis to meet competition would result in the eventual complete triumph of the railroads in intermodal competition because of their ability to impose all their constant costs [14] on traffic for which there was no competition.

The economists who testified for the railroads in this case all stated that such an unequal allocation of constant costs among shippers on the basis of demand for railroad service, *i. e.*, on the existence of competition for particular traffic,[15] was economically sound and desirable. Apart from the merits of this contention as a matter of economic theory,[16] it is quite clear that it was

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[14] Constant costs are, broadly speaking, those items of expense which are incurred by a business regardless of the scale of its operations. They are essentially the equivalent to what is commonly called overhead expenses. For railroads constant costs include such items as real estate taxes, certain rents, much right-of-way maintenance expense and similar expenses.

[15] Unequal allocation of constant costs as an element of the rate charged also occurs commonly where a bulky commodity is so low valued on a per ton basis that setting a rate by reference to the fully distributed cost of carrying the commodity would make it uneconomic to ship it. See n. 11, *supra*.

[16] This Court is not particularly suited to pass on the merits of the economic arguments made by the railroads' expert witnesses in this case. Moreover, their soundness is not especially relevant to the result we reach in the present posture of this controversy. However, because the economic testimony is emphasized so heavily by both the railroads and the United States in their arguments to us, we shall venture a few observations on it.

Most of the economic testimony is directed towards proving that the utilization of out-of-pocket costs in setting rates permits the

a contention that was not by any means wholly accepted by the Congress that enacted § 15a (3). One of the specific examples given of an undesirable practice, and accepted by the members of the Commerce Committee

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railroads to maximize their profits. To the extent that out-of-pocket costs are accurately computed, that proposition appears uncontrovertible. The economists then go on to argue, in effect, that what is good for the railroads is good for the country. This argument is developed as follows. Whenever a railroad lowers its rate, the shipper to whom that rate is available benefits. As long as the rate is above the out-of-pocket cost of the service, the railroad benefits by obtaining the profits from traffic it formerly did not carry. The fact that a competing carrier may lose the revenue it previously earned by carrying the traffic is immaterial because the railroad's ability to make a profit by charging the lower rate shows that it is, in some sense, more efficient than its competitor.

In order to evaluate the foregoing argument certain other aspects of a railroad's operation must be kept in mind. The reason why a railroad's fully distributed costs are substantially greater than its out-of-pocket costs on any given traffic is, *inter alia*, because certain constant costs, see n. 14, *supra*, are allocated to that traffic on a proportional basis despite the fact that those costs will be incurred by the railroad whether it carries the particular traffic or not. These constant costs must be earned if the railroad is to stay in business. They are allocated proportionally on the theory that, all other factors being equal, such an allocation will be the best way of assuring that each shipper contributes his fair share towards covering the constant costs. Obviously to the extent that any shipper pays more of the constant costs than another without any good reason for so doing that shipper is, in some sense, discriminated against.

The railroad economists point out that, because constant costs by definition are not attributable to the carriage of any particular traffic, it is to some extent arbitrary to allocate them to particular traffic. They further contend that all shippers presently utilizing a railroad's services are benefited when the railroad obtains additional traffic at a profit to it, because that profit can be used to pay a portion of the constant costs currently being charged wholly to them. The fact that charging a rate less than its fully distributed cost of carrying the traffic results in the shipper of that freight

that drafted the statute as such, was a case in which certain railroads had engaged in day-to-day differential pricing on the carriage of citrus fruit from Florida depending on whether competitive carriage was available

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paying a disproportionally low share of the railroad's constant costs is considered to be outweighed by the overall benefit to the other shippers of having the absolute amount borne by them of the constant costs decreased by the profit earned on the traffic.

It seems apparent, however, that in a case where the sole reason that a rate below fully distributed cost is necessary to attract such additional traffic is the competition of another mode of transportation, the continued existence of that competition is also the sole economic justification for maintaining the rate at a relative level that favors one shipper over others. If the competing carrier is driven out of business because of its inability to match the railroad's lower rates set on an out-of-pocket basis, the economic justification for permitting the continuation of those low rates would seem to disappear. Yet the railroad economists assert that in such a situation the railroad should be required by the ICC to maintain the rate at its original level. The obvious reason for this position is that permitting a railroad to raise its rates once it had effectively destroyed a competitor in one area would enable it to price on an out-of-pocket basis in competition with another carrier in a different area thereafter and, in turn, drive that carrier out of business. Eventually a railroad could eliminate all its competitors whose out-of-pocket costs were higher than its own. After this was accomplished the railroad could re-price all its services on a fully distributed cost basis thereby eliminating all discrimination between its shipper customers.

Of course, the shippers formerly served by competing modes at rates profitable to them but lower than the railroad's fully distributed costs would at that point have lost the advantage of the low cost service. The only way to perpetuate the advantage previously enjoyed by those shippers would be, as the railroad economists recognized, artificially to maintain their rates at the former level despite the absence of present economic justification for such a low rate. (It is true that were the barriers to reentry into the transportation market low, as asserted by the railroad economists, the potential competition created by the possibility of such reentry by a competing mode could furnish an economic justification for the continuance of the original low rate. However, there is no factual

by ship that day. See Hearings, *supra*, at 153–155. Similar complaints were made about seasonal variations in rates by railroads depending on whether winter conditions interfered with the carriage of freight by water. *Id.*, at 162–163. Yet, from an economic standpoint, such rate variations make perfect competitive sense insofar as maximization of railroad revenues is concerned.[17]

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evidence in this record from which it can be concluded that barriers to re-entry are low enough to create such potential competition.)

If the only justification for the maintenance of a disproportionally low rate to some shippers is the fact that competition existed once upon a time for their business, would it be irrational to conclude that it would be preferable to keep the original competition in business to serve those shippers and to require the railroad to look elsewhere for additional revenue? Would it, for example, be possible for railroads to increase their revenues instead by increasing, through selective rate decreases, the volume of traffic shipped by persons who presently pay amounts in excess of the fully distributed cost for the service afforded them? These are only a few of the questions that come to mind when we attempt to evaluate the economic arguments made in this case. We do not pretend to be able to answer them. We merely note their existence as evidence that we do not find the arguments made to the ICC here as compelling as did the District Court.

Our discussion here should not be interpreted as a rejection of the basic economic points made by the railroads. It is merely intended to illustrate the desirability of having the initial resolution of these issues made by a tribunal, and in a proceeding, more suitable than the present one.

[17] It is, of course, true that such discriminations need have no necessary relationship to a railroad's cost of service, whether that is computed on a fully distributed or out-of-pocket basis. On the other hand, it is also evident that what is basically at issue is a carrier's right to price discriminatorily, either between shipments or shippers, in order to maximize revenues by competition. By contrast it can be noted that the railroads have apparently retained their prior rate of $11.86 per ton on ingot molds in areas where they have no competition from barge-truck service. The discrimination thus created is not too dissimilar from that embodied in the above examples.

The simple fact is that § 15a (3) was not enacted, as the railroads claim, to enable them to price their services in such a way as to obtain the maximum revenue therefrom. The very words of the statute speak of "preserv[ing]" the inherent advantages of each mode of transportation. If all that was meant by the statute was to prevent wholly noncompensatory pricing by regulated carriers, language that was a good deal clearer could easily have been used. And, as we have shown above, at least one version of such clear language was proposed by the railroads and rejected by the Congress. If the theories advanced by the economists who testified in this case are as compelling as they seem to feel they are, Congress is the body to whom they should be addressed. The courts are ill-qualified indeed to make the kind of basic judgments about economic policy sought by the railroads here. And it would be particularly inappropriate for a court to award a carrier, on economic grounds, relief denied it by the legislature. Yet this is precisely what the District Court has done in this case.

We do not mean to suggest by the foregoing discussion that the Commission is similarly bound from making legislative judgments about matters of economic policy. It is precisely to permit such judgments that the task of regulating transportation rates has been entrusted to a specialized administrative agency rather than to courts of general jurisdiction. Of course, the Commission must operate within the limits set out by Congress in enacting the legislation it administers. But nothing we say here should be taken as expressing any view as to the extent that § 15a (3) constitutes a categorical command to the ICC to use fully distributed costs as the only measure of inherent advantage in intermodal rate controversies. As was stated in the *New Haven* case, it "may be" that after due consideration another method of costing will prove to be preferable in such situations as the present

one. All we hold here is that the initial determination of that question is for the Commission.

It is in this connection that the timing of this case takes on particular significance. We have already observed that the ICC has presently pending before it a broad-scale examination of the whole question of the cost standards to be used where comparisons of intermodal cost advantages are required. Rather than await the result of that rulemaking proceeding, the railroad appellees here determined to attempt to raise precisely the same issues in a much more circumscribed proceeding by unilaterally reducing their rates on one item of traffic. The District Court totally ignored the temporary nature of the ICC's action in this case and the pendency of the rulemaking proceeding. Instead, it went ahead and, in the guise of resolving this particular controversy over a single rate reduction, rendered a decision which, for all practical purposes, made the rulemaking proceeding moot. While there might be some justification for such a course when the applicable statute clearly requires the agency to arrive at a given result, this case is emphatically not such a situation. As this Court stated in *New Haven,* "[t]hese and other similar questions should be left for initial resolution to the Commission's informed judgment." 372 U. S., at 761.

The Commission stated here that it intended to exercise its informed judgment by considering the issues presented here in the context of a rulemaking proceeding where it could evaluate the alternatives on the basis of a consideration of the effects of a departure from a fully distributed cost standard on the transportation industry as a whole. Until that evaluation was completed, the Commission took the position that it would continue to follow the practice it had observed in the past of dealing with individual rate reductions on a fully distributed cost basis. The District Court, in effect, refused to per-

mit the Commission to deal with the complex problems of developing a general standard of costing to use in determining inherent advantage in situations involving intermodal competition in the broad context of a rule-making proceeding. Instead, it ordered the Commission to resolve those problems in the narrow context of this individual rate reduction proceeding.

We have already observed that the District Court erred in interpreting the *New Haven* decision to require the Commission to permit out-of-pocket pricing in most instances. Given the fact that *New Haven* indicated that the Commission was to exercise its informed judgment in ultimately determining what method of costing was preferable, it is clear that the District Court also erred in refusing to permit the Commission to exercise that judgment in a proceeding it reasonably believed would provide the most adequate record for the resolution of the problems involved. We can see no justification for denying the Commission reasonable latitude to decide where it will resolve these complex issues, in addition to how it will resolve them. The action by the District Court here not only deprives the Commission of the opportunity to make the initial resolution of the issues but also prevents it from doing so in a more suitable context.

This Court has just recently held that the Federal Power Commission had the authority to fix rates on an area-wide basis rather than on an individual producer basis and that, in order to make such a procedure feasible, it had statutory authority to impose a moratorium upon rate increases by producers for a period of 2½ years after the setting of the area rate. *Permian Basin Area Rate Cases*, — U. S. — (1968). The basis for this holding was the principle that the "legislative discretion implied in the rate-making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determi-

nation itself." *Id.*, at —. That principle is equally applicable to rate regulation carried out by the ICC, especially where, as here, the determination made on an interim basis is in general accord with both the legislative history of the statute involved and the results in prior cases decided by the agency. Accordingly, we hold that the Commission had ample authority to decline to deal with the broad contentions advanced by the railroads in this individual rate case and that the District Court erred in failing to recognize that authority.

The District Court also objected to the failure of the Commission to explain why it permitted out-of-pocket ratemaking where the competing carrier was unregulated and not where the competitor was regulated. The short answer to this is that § 15a (3) by its own terms applies only to "modes of transportation subject to this Act," which by definition means regulated carriers. As a result any arbitrariness that may flow from the distinction recognized by the Commission between regulated and unregulated carriers in situations of intermodal competition is the creation of Congress, not of the Commission.

The District Court also appears to have held that the Commission did not adequately explain how the rate set by the railroads would impair or destroy the barge-truck inherent advantage. Yet the Commission pointed out that the principle proposed by the railroads would, if recognized, permit the railroads to capture all the traffic here that is presently carried by the barge-truck combination because the railroad's out-of-pocket costs were lower than those of the combined barge-truck service. The District Court seems to have been impressed by the fact that the railroads were merely meeting the barge-truck rate, despite the uncontroverted evidence that given equal rates all traffic would move by train. Given a service advantage, it seems somewhat unrealistic to suggest that rate parity does not result in undercutting the

competitor that does not possess the service advantage. In any event, regardless of the label used, it seems self-evident that a carrier's "inherent advantage" of being the low cost mode on a fully-distributed cost basis is impaired when a competitor sets a rate that forces the carrier to lower its own rate below its fully distributed costs in order to retain the traffic. In addition, when rate war would be likely to eventually result in pushing rates to a level at which the rates set would no longer provide a fair profit, the Commission has traditionally, and properly, taken the position that such a rate struggle should be prevented from commencing in the first place. Certainly there is no suggestion here that the rate charged by the barge-truck combination was excessive and in need of being driven down by competitive pressure. We conclude, therefore, that the Commission adequately articulated its reasons for determining that the railroads' rate would impair the inherent advantage enjoyed by the barge-truck service.

The judgment of the District Court is reversed and the cases are remanded to that court with directions to enter a judgment affirming the Commission's order.

It is so ordered.

MR. JUSTICE DOUGLAS, dissenting.

I would affirm the judgment below for the reasons stated by the District Court in 268 F. Supp. 71.

SUPREME COURT OF THE UNITED STATES

Nos. 797, 804, 808, and 809.—October Term, 1967.

American Commercial Lines, Inc., et al., Appellants,
797 v.
Louisville & Nashville R. Co. et al.

American Trucking Associations, Inc., et al., Appellants,
804 v.
Louisville & Nashville R. Co. et al.

The American Waterways Operators, Inc., Appellant,
808 v.
Louisville & Nashville R. Co. et al.

Interstate Commerce Commission, Appellant,
809 v.
Louisville & Nashville R. Co. et al.

On Appeals From the United States District Court for the Western District of Kentucky.

[June 17, 1968.]

Mr. Justice Harlan, concurring in the result.

As I understand the Court's position, it is that the Commission has not decided, and thus the Court need not decide, the question expressly left open in *ICC* v. *New York, N. H. & H. R. Co.*, 372 U. S. 744: whether out-of-pocket costs, fully distributed costs, or some third standard should be the criterion for determining, under § 15a (3) of the Interstate Commerce Act, 49 U. S. C. § 15a (3), and the National Transportation Policy (preceding § 1 of the Act), which mode of transportation has the inherent advantage. The reasoning of the Court's opinion is, I take it, that the Commission may properly adhere to a fully distributed costs standard pending its

decision in a separate rulemaking proceeding, entitled Rules Governing the Assemblying and Presenting of Cost Evidence, Docket No. 34013.

Although I do not doubt that an administrative agency may, where the orderly processes of adjudication or rulemaking require, defer the resolution of issues to more appropriate proceedings,[1] I should have had the greatest difficulty in saying that in fact this had occurred, or had been intended to occur, in these cases.[2] Nonetheless,

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[1] I do not, however, believe that the Court's position is really supported by its references to the area pricing and moratoria systems approved by the Court in the *Permian Basin Area Rate Cases*, — U. S. —. The Court's opinion in those cases emphasized that those administrative devices were warranted in light of the terms of the Natural Gas Act and of the extraordinary difficulties of regulating independent producers of that commodity. I should not have thought it useful or desirable to extrapolate from those unusual circumstances any general extension of the discretion of administrative agencies. Of course, the specific proposition taken by the Court today from the opinion in those cases, which had in turn been taken from *Los Angeles Gas Co.* v. *Railroad Commission*, 289 U. S. 287, 304, may be regarded as a general principle sustained by a number of the Court's opinions. The difficulty, I should have supposed, is that even that general proposition is only dimly relevant to the questions now before us.

[2] The appearance and disappearance of the suggestion that these questions must be deferred pending the Commission's rulemaking proceedings on the presentation of cost evidence deserves a more complete chronicle than the Court has given. In 1965, more than three years after the Commission initiated its rulemaking proceeding, 27 Fed. Reg. 4102, and some two months before it decided these cases, the Commission held that "a comparison of out-of-pocket costs is the most appropriate method for ascertaining . . . inherent competitive advantage" where one of the competing modes is unregulated. The Commission found it unnecessary to defer that question, or even to mention its separate rulemaking proceeding. *Grain in Multiple-Car Shipments—River Crossings to the So.*, 325 I. C. C. 752, 772.

In the present case, the report and order of the Commission's Division 2 indicated that it "adhere[d] to the utilization of fully

given both the Court's conclusion and the isolated statements in the Commission's opinion consistent with that conclusion, I believe it best to acquiesce in the result reached by the Court, rather than to express my views

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d[illegible]ibuted costs as the standard for determining the inherent advantage of low cost in the situation presented." 323 I. C. C. 758, 762–763. The opinion did not pause to refer to the rulemaking proceeding. In the report and order of the full Commission on reconsideration, the only reference to the rulemaking proceeding was the brief passage quoted by the Court from the opinion's final section. 326 I. C. C. 77, 84. The three dissenting members of the Commission found it unnecessary to refer to the rulemaking proceeding. *Id.*, at 85, 86, 90.

One year after its decision in these cases, the Commission had occasion to review its approach to these problems. Although the Commission adhered to its decisions in these cases and in *Grain in Multiple-Car Shipments—River Crossings to the So., supra,* it did not find it necessary to advert to its separate rulemaking proceedings. It concluded that where the competition from a regulated carrier is "relatively limited" it would apply the rule from *Grain in Multiple-Car Shipments,* and not that from these cases. There is no evidence whatever that the Commission regarded these two lines of authority merely as temporary expedients, useful only until more careful analysis is possible. *Wine, Pacific Coast to the East,* 329 I. C. C. 167, 171–175. And see the concurring opinions of Vice-Chairman Tucker and Commissioner Freas, *id.*, at 176, as well as the separate opinion of Commissioner Murphy, dissenting in part, *id.*, at 177.

Although the three-judge District Court set aside the Commission's order in these cases, it did not mention the rulemaking proceeding. 268 F. Supp. 71.

In its jurisdictional statement to this Court, the Commission adverted to the rulemaking proceeding only in a single sentence, with an identifying footnote, contained in the statement's conclusion. Jurisdictional Statement in No. 809, at 17. In the memorandum of the United States, urging that probable jurisdiction be noted, it was said that these cases "present a major issue reserved by this Court" in *New Haven,* which was "whether out-of-pocket costs, fully distributed costs, or 'some different measure' should be the criterion for determining which mode of transportation has the

as a single Justice upon the issue which the Court shuns.[3]

I would be less than candid if I did not say that I regard this disposition of these cases as u atisfactory, for what is now done leaves this important question just where our decision of five years ago in the *New Haven* case left it, and new litigation will now be necessary to resolve the issue.

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inherent advantage . . . ." Memorandum for the United States 3–4. In the various briefs presented to the Court in these four cases, including the briefs of the United States and of the Commission, I have looked in vain for any suggestion that, as the Court now holds, the Commission's opinion was intended merely to defer resolution of the question reserved in *New Haven*. Indeed, I have searched unsuccessfully in the Commission's brief for any reference, however fleeting, to the rulemaking proceeding. One might have supposed that if, as the Court now finds, the existence of the rulemaking proceeding was, *in the Commission's view*, decisive to the result of this case, the Commission would have found room in its brief of 51 pages at least to cite those proceedings. It is difficult to escape the inference that the Court has, on a basis that will doubtless prove as surprising to the parties as it did to me, simply postponed decision of a difficult issue.

[3] It is, however, proper to add that I have found no support in the record for the Court's suggestion that "the railroad appellees here determined to attempt to raise precisely the same issues [as in the rulemaking proceeding] in a much more circumscribed proceeding by unilaterally reducing their rates on one item of traffic." *Ante*, at 18.